92-882

NO. _____

Supreme Court, U.S.
FILED
NOV 19 1992
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

October Term, 1992

GREYHOUND EXHIBITGROUP, INC.,

Respondent,

vs.

E.L.U.L. REALTY CORP.,

Petitioner,

ANTHONY GALLINA d/b/a GALLINA SPRINKLER SYSTEMS, and A. GALLINA SPRINKLER SYSTEMS and A. GALLINA HEATING AND MECHANICAL SPRINKLER CORP.,

Defendants.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

NOEL W. HAUSER, *Of Counsel*
Stephen H. Penn & Associates
Attorneys for Elul Realty
10 Rockefeller Plaza
New York, New York 10020
(212) 245-4050

DICK BAILEY SERVICE (212) 608-7666 (718) 447-5358 (516) 222-2470 (914) 682-0848 Fax (718) 273-8031
1-800-564-4913

QUESTIONS PRESENTED

1. In view of the teaching of Fed. R. Civ. P. 8(d) that a defendant in default does not admit damages, did the Second Circuit's majority opinion correctly rule that plaintiff's contributory negligence in a negligence case could not be shown in mitigation of damages, especially since applicable State Law also provides for mitigation in the circumstances?

2. Is a plaintiff relieved of its burden of demonstrating causal relationship between negligence and damages by the mere fortuity of the

defendant's default; and may the defendant show concurrent causes of the damages claimed in mitigation?

3. Does Due Process permit a Court to impose upon a defendant in default the full burden of damages sustained, without any allocation as to fault, notwithstanding that the complaint alleged only that the defendant had exacerbated the damages?

4. Did the Circuit Court improperly rule that the defendant in default was precluded from pursuing a claim against the plaintiff when the District Court had specifically reserved judgment on that issue?

5. Does the Doctrine of Collateral Estoppel, as opposed to Res Judicata, apply to a default judgment rendered by a Federal Court applying Federal Law?

6. Did the Second Circuit properly conclude that a defendant's claim for indemnity must be asserted as a compulsory counterclaim where conditions under which indemnity was to be provided did not exist at the time for service of counterclaims and in any event the facts giving rise to the counterclaims were unknown to the putative counterclaimant?

7. Does Due Process permit a Court to enter a default

judgment against a defendant, briefly in default in serving a timely answer but with an admittedly meritorious defense, because the defendant has failed to satisfy financially onerous terms of a conditional vacatur without so much as a hearing to determine whether the terms could be met?

PARTIES TO THE PROCEEDINGS

The original parties to this case were Greyhound Exhibitgroup, Inc. ("GEX"), as the plaintiff, and Elul Realty Corp. ("Elul"), Anthony Gallina d/b/a Gallina Sprinkler Systems and A. Gallina Heating and Mechanical Sprinkler Corp. (collectively, "the Gallina defendants") as the defendants. The suit against the Gallina defendants ended by voluntary discontinuance after the action against Elul proceeded to inquest. Although the caption was not altered, the only parties before the Circuit Court were GEX, plaintiff-appellee, and Elul, defendant-appellant.

Elul Realty Corp. has no parent or subsidiaries.

TABLE OF CONTENTS

Questions Presented. . . . . .*i*

Parties to the Proceedings. . . . . *v*

Table of Authorities. . . . . *vii*

Opinions Below. . . . . .*xi*

Jurisdiction of the Supreme Court. *xiii*

Statutes Involved. . . . . .*xiv*

Statement of the Case. 1

Reasons for Granting the Writ. . . . 14

ARGUMENT

I. The Formulation of GEX's Damages. 18

A. Causation. 18

B. Facts in Mitigation of Damages. 21

II. The Effect of the Failure of a Defendant in Default To Assert Compulsory Counterclaims And the Federal Rule on Collateral Estoppel. 29

III. The Refusal To Modify the Conditions for Vacatur of the Default Deprived Elul of its Constitutional Right To a Day in Court. 40

Conclusion. 44

TABLE OF AUTHORITIES

Cases *Pages*

Amusement Business Underwriters Inc. v. American Int'l Group,
66 N.Y.2d 878,
498 N.Y.S.2d 760 (1985). 21

Carteret Savings and Loan Association v. Jackson,
812 F.2d 36 (1st Cir. 1987). . .30

Dillon v. Twin State Gas & Electric Co.,
163 A. 111 (N.H. 1932). 25

Fehlhaber v. Indian Trails, Inc.
425 F.2d 715 (3d Cir. 1970).23,.24

487 Elmwood Inc. v. Hassett
161 A.D.2d 1171, 556 N.Y.S.2d 425
(4th Dept. 1990). 40

Hammond Packing Co. v. State of Arkansas,
212 U.S. 322, 29 S. Ct. 370, 53 L.
Ed. 530 (1908). 41

Hovey v. Elliot,
167 U.S. 409, 17 S. Ct. 370, 42 L.
Ed. 215 (1897). 41

Huddell v. Levin,
537 F.2d 726 (3d Cir. 1976). . .26

J & P Construction Co. v. Valta Construction Co.,
452 So.2d 857 (Ala. 1984). . . .22

Jensen v. Chevron Corp.,
160 A.D.2d 767, 553 N.Y.S.2d 485
(2d Dept. 1990). 40

Kinney v. G.W. Lisk Co.,
76 N.Y.2d 215,
557 N.Y.S.2d 283 (1990). 39

Kohlenberger v. Tyson's Foods,
510 S.W.2d 555 (Ark. 1974). . . 21

Lawlor v. National Screen Service,
349 U.S. 322, 75 S. Ct. 865, 99 L. Ed. 1122 (1955). 34

Logan v. Zimmerman,
455 U.S. 422, 102 S. Ct. 1148, 71 L. Ed.2d 265 (1983). 41

Matter of Lombard,
739 F.2d 499 (10th Cir. 1984). .34

Matter of McMillan
579 F.2d 289 (3d Cir. 1978). . .35

McClelland v. Climax Hosiery Mills,
252 N.Y.2d 347 (1930). 21

Montgomery Elevator Co. v. Building Engineer Services Co.,
730 F.2d 337 (5th Cir. 1984). . 39

Nichols v. Anderson,
788 F.2d 1140 (5th Cir. 1986). .32

Peter Fabrics, Inc. v. S.S. Hermes
765 F.2d 306 (2d Cir. 1985). . .37

Reynolds v. Hartford Accident and Indemnity Co.,
278 F. Supp. 331 (S.D.N.Y. 1967)39

Scafidi v. Seiler,
199 N.J. 93, 574 A.2d 398 (1990)26

Steinhauser v. Hertz,
421 F.2d 1169 (2d Cir. 1970). . 26

Thorpe v. Thorpe,
364 F.2d 692 (C.A.D.C. 1966). . 41

Tibbetts v. IBM,
161 A.D.2d 581, 551 N.Y.S.2d
160 (2d Dept. 1990). 40

Transworld Airlines v. Hughes,
449 F.2d 51 (1971),
rev'd on other grounds
409 U.S. 363 (1973). 19,.20

Tutt v. Doby,
459 F.2d 1195 (C.A.D.C. 1972). .34

U.S. v. International Building Co.,
345 U.S. 502, 73 S. Ct. 807,
97 L. Ed. 1182 (1953). 35

Treatises and Law Reviews

47 *Am. Jur.* 2d Judgments 1187. . . . 21

15 *A.L.R.*3d 607. 21

25A *Corpus Juris Secundum*
section 184 (1966 ed.). 21,.25

Harper, James and Gray,
The Law of Torts, section 20.3
(2d ed. 1986). 26

King, *Causation, Valuation and Chance
in Personal Injury Torts Involving
Preexisting Conditions
and Future Consequences*,
90 Yale L.J. 1353 (1981). . . . 26

J.W. Moore, 1B *Moore's Federal Practice*,
¶ 0.444[2] (1992 ed.). 34

Polasky, *Collateral Estoppel—Effects of Prior Litigation*,
39 Iowa Law Review 217 (1954). . 35

Restatement (Second) of Judgments
¶ 27 comment (e) (1980 ed.). 35

Statutes

Fed. R. Civ. P. 8(d)18, 19, 21, 23, 24

Fed. R. Civ. P. 13(a). . . . 15, 30, 31

Fed. R. Civ. P. 13(b). 38

N.Y. Civ. Prac. L. & R. 1411. 24

OPINIONS BELOW

Neither the Judgment nor any of the opinions rendered in this case has been officially reported. Unreported opinions relevant to this Petition and annexed as an Appendix at 1a to 68a are as follows:

Decision on Appeal of the United States Circuit Court for the Second Circuit: No. 92-7545 slip op. (August 24, 1992);

Memorandum and Order of the Hon. I. Leo Glasser, United States District Judge, adopting Report and Recommendation of United States Magistrate Judge following inquest (E.D.N.Y. April 22, 1992);

Memorandum and Order of United States District Judge I. Leo Glasser refusing to modify condition on vacatur (E.D.N.Y. July 29, 1991).

JURISDICTION OF THE SUPREME COURT

The Judgment and Opinion of the Second Circuit was rendered on August 24, 1992. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. section 1254(1).

STATUTES INVOLVED

Fed. R. Civ. P. 8(d) provides:

> "Averments in a pleading to which a responsive pleading is required, other than those as to the amount of damage, are admitted when not denied in the responsive pleading * * *"

28 U.S.C. (Underscoring added.)

Fed. R. Civ. P. 13(a) provides:

> Compulsory counterclaims. A pleading shall state as a counterclaim any claim which at the time of serving the pleading, the pleader has as against any opposing party, if it arises out of the transaction or occurrence which is the subject matter of the opposing party's claim * * *"

28 U.S.C.

Fed. R. Civ. P. 55(c) provides:

> "Setting aside default. For good cause shown, the Court may set aside an entry of default and, if a judgment by default has been entered, may likewise set it aside in accordance with Rule 60(b)."

28 U.S.C.

The Fifth Amendment to the United States Constitution provides, in pertinent part, as follows:

> "No person shall be . . . deprived of life, liberty or property, without due process of law."

U.S. Constitution Amendment V.

New York CPLR 1411 provides in pertinent part:

> "In any action to recover damages for * * *injury to property * * * the culpable conduct attributable to the claimant * * * including contributory negligence shall not bar recovery, but the amount of damages otherwise recoverable shall be diminished in the proportion which the culpable conduct attributable to the claimant * * * bears to the culpable conduct which caused the damages."

28 U.S.C.

The Fifth Amendment to the United States Constitution provides, in pertinent part, as follows:

> "No person shall be . . . deprived of life, liberty or property, without due process of law."

U.S. Constitution Amendment V.

New York CPLR 1411 provides in pertinent part:

> "In any action to recover damages for * * *injury to property * * * the culpable conduct attributable to the claimant * * * including contributory negligence shall not bar recovery, but the amount of damages otherwise recoverable shall be diminished in the proportion which the culpable conduct attributable to the claimant * * * bears to the culpable conduct which caused the damages."

STATEMENT OF THE CASE

This case presents the important Constitutional question whether a defendant, briefly in default in interposing its answer, may be denied the right to prove an admittedly meritorious defense by conditioning without a hearing terms impossible to satisfy as a practical matter, thus rendering the conditional vacatur essentially an unconditional denial. Additionally, the case poses the question whether, consistent with Due Process, a defendant in default in answering may be burdened with the full measure of his adversary's damages, unallocated as to fault or causation, notwithstanding that the complaint as to which the defendant defaulted did not allege that the defendant had caused all the damages but only that he had

exacerbated them. Stated otherwise, this petition asks whether a plaintiff that, by luck of the draw, obtains a default judgment is thereby relieved from the necessity of demonstrating that the defendant in default caused all the damages claimed. Important additional questions are presented concerning the interrelationship, if any, between Fed. R. Civ. P. 13(a), dealing with compulsory counterclaims, and the effect thereof on traditional notions of Collateral Estoppel in the context of a default in answering, and the propriety of a Circuit Court ruling on the issue absent any determination in the District Court.

These questions arise from the following set of facts and procedural history. Petitioner, Elul Realty Corp. (hereafter "Elul") was at all relevant

times the landlord of a commercial building in Brooklyn, New York. Respondent, Greyhound Exhibitgroup, Inc. (hereafter "GEX") was the major tenant in the building and conducted manufacturing operations, including the large scale use of combustible substances, thereat. Early on Saturday morning, February 13, 1988, a fire broke out in GEX's premises as a result of horseplay among its employees, resulting in substantial damage from contact with the combustible substances.

Some months following the fire, Elul initiated eviction proceedings against GEX for non-payment of rent. GEX, for its part, filed its own suit against Elul (and the Gallina parties defendant) alleging, in substance, that the spread of the fire was exacerbated because the fire

sprinkler system, the maintenance of which was the primary responsibility of the Gallina defendants, did not function properly. Elul's statutory agent for the receipt of process was served.

Elul was covered by a $500,000 policy of liability insurance in its favor; also, the lease between Elul and GEX obligated GEX to furnish $1 million in liability insurance for the benefit of Elul. Possibly as a result of confusion concerning primary responsibility for the defense of the action initiated against it by GEX, no answer was interposed by Elul or any insurance carrier in its behalf to GEX's complaint before due date of the answer in November of 1988; and Elul's default was noted at that time. It is to be observed that, according to the opinion of the Second Circuit, Elul's claims

against GEX for indemnity (based upon GEX's duty to furnish insurance as provided by the lease) became barred and forever foreclosed upon Elul's default in failing to serve an answer to the complaint containing what the Second Circuit found was a "compulsory counterclaim" within twenty days of service upon its agent of the Summons and Complaint.

Elul made its first application to vacate its default as early as December 1988. The application to vacate was opposed by GEX, ironically on the ground that Elul's insurance coverage of only $500,000 was not enough to pay the damages occasioned.[1] It should be noted that,

---

[1] Although obligated by the lease to furnish $1 million in liability insurance coverage for the benefit of Élul, GEX evidently failed to keep the coverage in force, a fact which first came to light when, ironically, GEX

in fact, GEX maintained first-party coverage on its own property under a policy which contained a $500,000 deductible clause; thus, the claims of "inadequacy" of Elul's insurance coverage were being advanced by GEX's first-party insurance carrier as subrogee for the amounts it was required to pay to GEX.

Eventually, the Honorable John L. Caden, United States Magistrate Judge, to whom the matter of vacating the default had been referred by then United States District Judge Joseph McLaughlin, recommended that the default be vacated on the posting by Elul of a bond for $1 million. In reaching this conclusion the Magistrate

---

charged that Elul had insufficient insurance coverage. This was long after the time to file a counterclaim, when Elul was already in default.

Caden observed that Elul had a meritorious defense. However, Elul had previously executed a mortgage on its property to raise funds to repair the fire damage without giving prior notice to parties to the litigation, as required by Magistrate Caden's initial interim Order, issued while the Magistrate's original Report and Recommendation, proposing unconditional vacatur, was awaiting consideration by then-District Judge Joseph M. McLaughlin. Because the mortgage had been executed and no notice had been given, Judge McLaughlin had recommitted to the Magistrate the issue whether to vacate the default, At that point Magistrate Caden again recommended that the default be vacated, this time recommending the $1 million bond. This was two years after the default and 23

months after Elul first made its application to vacate. Judge McLaughlin accepted Magistrate Caden's second recommendation and gave Elul only 30 days from November 7, 1990 (the date of the Order) within which to produce and file the $1 million bond.

In the meantime Elul and its counsel had parted company, undoubtedly because of the default, for which Elul held counsel responsible, and because of counsel's failure to advise Elul of the notice requirement earlier imposed by the interim Order of Magistrate Caden. At all events, Elul engaged new counsel at the end of November 1990. Elul's new counsel then wrote the Honorable I. Leo Glasser, United States District Judge, who assumed responsibility for this case upon Judge McLaughlin's elevation to the Second Circuit bench, on December 13,

1990, advising that Elul could not furnish the $1 million bond but that it was prepared to furnish alternative and entirely adequate security. Judge Glasser did not respond; instead, on or about March 20, 1991, he signed an Order directing an inquest.

Elul promptly moved for reconsideration, offering in substitution for the $1 million bond (which Elul could not furnish because of economic conditions), the building itself as well as the personal guarantees of its three principals (individuals described by GEX itself as people of vast personal financial means). Judge Glasser refused without a hearing to consider any modification of the $1 million bond requirement, even ruling that the application was denied as untimely, and ignored Elul's request

for an evidentiary hearing on its claimed inability to post such a bond and on the sufficiency of the alternative collateral which Elul and its principals had offered.

By this time it was painfully clear to Elul and its new counsel that GEX had failed to keep in force and effect a policy of liability insurance in favor of Elul in the sum of $1 million as required by GEX's lease with Elul. On Elul's second application to vacate or modify the $1 million bond requirement, this point was made to Judge Glasser and the Court was referred to numerous cases decided by New York's appellate courts to the effect that, where a tenant violates a provision in its lease by which it is obligated to furnish liability insurance for the benefit of its landlord, the tenant is

to be treated as a self-insurer for the benefit of the landlord. Judge Glasser did not pass on the issue at that time, concluding that it should be dealt with in terms of the damage award following inquest, apparently on the grounds that a defendant in default has the right to be heard and to offer evidence on the issue of damages, Fed. R. Civ. P. 8(d). Judge Glasser nevertheless refused to reduce the amount of the bond although the insurance claim, for $1 million, was obviously worth almost as much as GEX's claimed damages of $1.5 million and should easily have secured its potential judgment.

At the inquest, GEX offered no evidence whatever on the issue of causation. Not improbably, its failure to do so was due to the fact that the existing proof unequivocably showed that

the fire originated in GEX's premises as a result of its employees' horseplay; and that, fairly read, GEX's complaint as to which Elul was in default simply claimed that the fire damage was *exacerbated*, not caused, by the failure of the fire sprinkler to operate properly. No effort was made by GEX to distinguish between preexacerbation and post-exacerbation damages; no effort was made to apportion damages between the parties according to the respective culpability of each of them as required by New York law; and Magistrate Caden, who conducted the inquest, refused to hear testimony from experts and firemen who attended at the scene of the fire, including the supervising Fire Marshal, in the face of an Elul's offer of proof that the supervising Fire Marshal would testify that the failure of the fire

sprinkler system to operate had little or nothing to do with exacerbating the fire and that what had in fact exacerbated the fire was the presence on the premises of the combustible substances stored thereon by GEX in violation of its lease. Judgment for $1.5 million plus interest was entered after inquest; Judge Glasser adopted the Magistrate's Report and Recommendation without considering Elul's argument that GEX was obligated to prove causation with respect to damages as well as liability; and the Second Circuit, over Judge Altimari's strong dissent in this regard, affirmed.

REASONS FOR GRANTING A WRIT OF CERTIORARI

The decision rendered by Judge Glasser directing entry of judgment, and the affirmance thereof by the Second Circuit, conflicts in at least three respects with earlier well-settled authority which forms the basis for numerous decisions and rules of law articulated by the United States Supreme Court, by other Circuit Courts throughout the United States and even with one decision, followed by all courts, rendered by the Second Circuit itself.

As will hereafter be demonstrated, the decision below overrules a significant body of case law holding that the doctrine of collateral estoppel, as opposed to res judicata, does not apply to a party in default to

preclude later assertion of independent claims against the beneficiary of the default. The Second Circuit's broad interpretation of the compulsory counterclaim rule, set forth at Fed. R. Civ. P. 13(a), ignores entirely the previously expressed limitations against applicability of the rule of collateral estoppel as against parties in default.

Secondly, the decision below ignores entirely the traditional requirement in cases involving unliquidated damages that the plaintiff show a causal link between the wrongful acts of the defendant and the damages alleged to have been caused thereby. This holding defies reason: Under the Second Circuit's new formulation, for example, the party claiming damages in a personal injury action arising out of an automobile accident could recover

damages against a defendant in default by showing he had lung cancer after, but not before, the accident.

Thirdly, the Court below ignored a decision by the Third Circuit holding that, where state law provides for application of comparative negligence, a plaintiff's proven damages, in a diversity case, must be reduced by the plaintiff's own culpable conduct in causing those damages. To the contrary, the Second Circuit held that, by reason of the defendant's default, the plaintiff's comparative negligence cannot be shown, even in mitigation, even where the complaint does not claim that the plaintiff was free of fault, and even when the complaint does not charge the defendant with having caused all the damage.

Finally, the Court below

ignored the principle that, where a Court has imposed terms impossible to meet as a condition to vacating a default, it deprives the defaulted party of its constitutional right to a day in court if alternative terms which can be satisfied are not even considered.

ARGUMENT

I. THE FORMULATION OF GEX'S DAMAGES.

The Courts below disregarded both settled case law and plainly worded legislative enactments in fixing plaintiff's damages.

A. CAUSATION.

Fed. R. Civ. P. 8(d) specifically excludes a defendant's default from having any impact on damages; stated otherwise, a defendant in default makes no admissions as to the damages claimed by the plaintiff. The Courts below effectively held, though, that while the default did not admit the quantum of damages alleged, it somehow admitted damages *not* alleged, *i.e.*, the preexacerbation damages attributable to GEX's own fault, which were not alleged to have been due to Elul's fault.

The majority opinion rendered

in this case by the Second Circuit is that the limitation imposed by Fed. R. Civ. P. 8(d) deals only with the quantum of damages and not the issue of causation. The dissenting opinion of Circuit Judge Altimari, relying upon the venerable Second Circuit decision in *Transworld Airlines Inc. vs. Hughes*, 449 F.2d 51, 69-70 (1971), *rev'd on other grounds*, 409 U.S. 363 (1973) (hereinafter, "*TWA*"), came to a contrary conclusion. *TWA* holds that, in the case of a default where the beneficiary thereof seeks unliquidated damages, that beneficiary must prove that the defendant caused the damages before an award can be made. The *TWA* Court stated in pertinent part at 449 F.2d 70:

> The default judgment did not give TWA a blank check to recover from Toolco any losses it had ever suffered from whatever source. It could

> only recover those damages arising from the acts and injuries pleaded and in this sense it was TWA's burden to show 'proximate cause.'"

TWA's teaching on the issue of proximate cause where a defendant is in default has been followed by almost every court on every level. The Second Circuit's majority opinion makes a distinction in *TWA*'s teaching which does not seem to be supported by reason or principle and, on the contrary, opens the door to mischievous results by allowing the beneficiary of a default to "prove" plainly unsupportable claims. The Decision likewise overlooks the fact that knowledgeable defendants are often prepared to concede the issue of liability in a proper case (rather than incur the costs of a full-fledged defense) where it appears that the plaintiff has not suffered or cannot

prove causation of substantial damage.

B. FACTS IN MITIGATION OF DAMAGES.

Independent of the provisions of Fed. R. Civ. P. 8(d), the rule in the Federal Courts, the rule in the courts of the state of New York—whose law applies in this diversity case—and the rule throughout the United States is that a defendant in default is under no disability whatever on the issue of contesting damages and may prove any facts in mitigation of damages. 25A *C.J.S.* Section 172 at 135; 47 *Am. Jur.* 2d Judg. Section 1187; 15 *A.L.R.* 3d 607; *Amusement Business Underwriters Inc. vs. American International Group*, 66 N.Y.2d 878, 498 N.Y.S.2d 760 (1985); *McClelland vs. Climax Hosiery Mills*, 252 N.Y. 347 (1930); *Kohlenberger vs. Tyson's Foods, Inc.*, 510 S.W.2d 555 (Sup. Ct. Ark.

1974); *J & P Construction Company vs. Valta Construction Co.*, 452 So.2d 857 (Sup. Ct. Ala. 1984).

The New York legislature has enacted comparative negligence legislation which provides that, in an action to recover damages for injury to property, the damages otherwise recoverable by the plaintiff upon a showing of negligence on the part of the defendant are to be reduced in proportion to the culpability of the plaintiff itself. The obvious import of this rule deals with damages.

In *Fehlhaber vs. Indian Trails, Inc.*, 425 F.2d 715 (3d Cir. 1970), plaintiff sued defendant for damages for negligence. Defendant joined a third-party defendant which defaulted in answering the third-party complaint. Following disposition of the

main action between plaintiff and defendant-third-party plaintiff, the third-party plaintiff moved for judgment against a third-party defendant in default. The District Judge directed a hearing to determine the comparative degree of fault of the parties as a predicate for the means of apportioning damages between the third-party plaintiff and third-party defendant, the default of the latter notwithstanding.

Upon appeal by the third-party plaintiff, the Third Circuit affirmed, concluding that the degree of fault of the respective parties:

> ". . . went to the extent of . . . damages and, therefore, by the express terms of Rule 8(d) F.R.C.P. was not to be taken as admitted by the default."

In stark contrast to the decision by the Third Circuit, the Second Circuit held, contrary to the

express language of Fed. R. Civ. P. 8(d) and New York CPLR 1411, that plaintiff's culpability could not be shown in mitigation of damages because of the defendant's default.

It is interesting to note that in *Fehlhaber*, the District Court found that the negligence of the third-party defendant contributed only slightly to the injuries sustained by the plaintiff. Perhaps it was for that reason that the third-party defendant, recognizing that its exposure was very limited, decided it was cheaper and easier to defend against damages rather than the claim on liability. The Second Circuit would deprive it of the freedom to make that determination by forcing the defendant to undertake litigation that might cost more than the value of the claims asserted.

Closely related to the concept of causation discussed above are the concepts of consecutive and concurrent negligence contributing to a loss sustained by a plaintiff. It is an elementary principle of the law of torts that a defendant may not be held liable in damages for injuries or conditions caused by others. 25A *C.J.S.* Section 184. Particularly in point is *Dillon vs. Twin State Gas & Electric Co.*, 163 A. 111 (N.H. 1932), the famous case of a boy who fell from a girder above a bridge and was electrocuted by wires he touched during the course of his fall. The Court concluded that damages recoverable from electrocution were limited since the boy would in any event have died or been seriously injured as a result of the fall. *Dillon* was relied upon by the Second Circuit in

Steinhauser vs. Hertz, 421 F.2d 1169 (2d Cir. 1970). To the same effect, *see Huddell vs. Levin*, 537 F.2d 726 (3d Cir. 1976); *Scafidi vs. Seiler*, 199 N.J. 93, 574 A.2d 398 (1990); King, *Causation, Valuation and Chance in Personal Injury Torts Involving Pre-Existing Conditions and Future Consequences*, 90 *Yale L.J.* 1353 (1981); Harper, James and Gray, *The Law of Torts*, Section 20.3 (2d ed. 1986).

At least three actors acting concurrently or consecutively were the cause of GEX's damages: Elul, the defendant; the Gallina defendants who were responsible for maintaining the fire sprinkler system; and Greyhound itself. The Second Circuit not only ignored a virtually unbroken line of precedent requiring a plaintiff in a tort case to prove proximate cause as to

damages as well as liability, but it also ignored the principle articulated by many other cases and dictated by due process considerations that a defendant should be required to pay only those damages for which he is responsible. In this connection it likewise ignored the fact these same considerations prohibit a court from entering judgment on default for an amount exceeding that alleged in the complaint. In this case, the Courts awarded GEX damages for the full amount of loss associated with the fire notwithstanding that the complaint had only charged Elul with some of those damages.

In its zeal to punish Elul for its post-default actions (and the record shows that no Court has ever found that Elul's post-default actions were contemptuous or even deliberate,

although the courts willingly assumed the worst), the Second Circuit bench went so far as to usurp the right and duty of District Judge Glasser to pass on the issue, then sub judice, whether Elul was entitled to a $1 million setoff for liability insurance coverage which GEX had agreed to furnish for the benefit of Elul but had failed to furnish. In his decision of July 29, 1991, Judge Glasser expressly ruled that GEX's failure to furnish coverage as required under its lease with Elul impacted on damages. Because Magistrate Caden, who conducted the inquest, refused to consider the issue, however, Elul's counsel moved to amend the complaint to assert the claim—a motion which, even as of this writing, District Judge Glasser has not resolved.

Reasonable minds could differ

as to whether Elul's claim in this regard should be treated as a setoff in mitigation of damages or as an independent claim. Perhaps it is both. In any event, with the matter undecided in the District Court, the Second Circuit ruled that Elul was foreclosed from pursuing the issue because it could have been asserted as a counterclaim; and that since it had not been so asserted because no answer had been served the issue is now altogether foreclosed by the default. This subject is treated at greater length in the next section.

I. THE EFFECT OF FAILURE OF A DEFENDANT IN DEFAULT TO ASSERT COMPULSORY COUNTERCLAIMS AND THE FEDERAL RULE ON COLLATERAL ESTOPPEL.

A Writ of Certiorari should be granted if only for the reason that the

broad reading by the Second Circuit of the compulsory counterclaim requirement, Fed. R. Civ. P. 13(a), on the subject of issue-preclusion follows the First Circuit's ruling in *Carteret Savings and Loan Association vs. Jackson*, 812 F.2d 36, 38 (1st Cir. 1987), but directly conflicts with recent decisions from the Fifth and Tenth Circuits and with the results reached by most of the courts that have considered the issue as well as text writers and commentators.

In this case, GEX's complaint charged Elul only with negligence in the maintenance of the fire sprinkler system in the building where the fire occurred. Elul does not dispute that, if the Court's refusal to vacate Elul's default in answering this complaint was justified, the issue of Elul's negligence is res judicata. However,

in affirming the judgment of the District Court, the Second Circuit went much further: It held that Elul's default foreclosed it from litigating other claims which, but for the default, Elul could have asserted against GEX by way of indemnity or by way of mitigation of damages. In so doing, it disregarded what must be considered as settled contrary authority and even took the extraordinary step of usurping the District Judge's right and duty to rule on the issue in the first instance. In effect, the Second Circuit sua sponte extended the effect of Fed. R. Civ. P. 13(a) far beyond its generally understood reach in default or consent judgment cases.

The principle of res judicata is that an issue once tried and decided is forever foreclosed; and the principle

is fully applicable to default judgments. The related but clearly distinguishable principle of collateral estoppel, when applicable, stands for the proposition that a party is foreclosed from litigating an issue which could have been, but was not, litigated in earlier litigation involving the same parties and related but not identical subject matter.

In the instant action, initiated by GEX in the District Court on diversity grounds, the Second Circuit ruled that Elul's default foreclosed it from asserting its claim for indemnity or by way of mitigation of damages, based upon GEX's failure to maintain $1 million in insurance coverage for the benefit of Elul, at a time when the issue was sub judice before the District Judge.

In *Nichols vs. Anderson*, 788 F.2d 1140 (5th Cir. 1986), the defendant raised as a defense a judgment obtained by default against the plaintiffs in an earlier litigation where the subject matter of the present action could have been, but was not, determined. In disallowing the defense, the Fifth Circuit stated as follows:

> In diversity cases, we apply Federal Collateral Estoppel Doctrine. *Freeman vs. Lester Coggins Trucking Inc.*, 771 F.2d 860 (5th Cir. 1985). The party seeking to invoke Collateral Estoppel must plead the defense, Fed. R. Civ. P. 8(c), and show:
>
> (1) That the issue at stake be identical to the one involved in prior litigation; [and] (2) That the issue has been actually litigated in the prior litigation; and (3) That the determination of the issue in the prior litigation has been a critical and necessary part of the judgment in that earlier action.
>
> * * *

> The record before us does not show that the validity of the radius-exclusion clause was 'actually litigated' in the Arkansas proceedings. * * * The default judgment status militates against the conclusion that the validity vel non of the radius-exclusion clause was before the Court. It strains credulity to believe that Canal put the validity of the clause at issue, and Woods made no appearance.

Moore's, *supra*, at ¶ 0.444[2], says this:

> [P]robably the preponderant view, and we think the better one, is that, as a general proposition, a default judgment has no Collateral Estoppel effect. To invoke the Doctrine of Collateral Estoppel in default cases is not only an oppressive application of the Doctrine, but it misconceives the nature of a default judgment.

To the same effect, *see Matter of Lombard*, 739 F.2d 499 (10th Cir. 1984); *Tutt vs. Doby*, 459 F.2d 1195 (C.A.D.C. 1972); *Lawlor v. National*

Screen Service, 349 U.S. 322, 75 S. Ct. 865, 99 L.Ed. 1122 (1955); *U.S. v. International Building Co.*, 345 U.S. 502, 73 S. Ct. 807, 97 L.Ed. 1182 (1953); *Matter of McMillan*, 579 F.2d 289 (3d Cir. 1978); *Restatement (Second) Judgments* (1980) ¶ 27, comment (e); Polasky, *Collateral Estoppel-Effects of Prior Litigation*, 39 Iowa Law Review 217, 226 (1954).

Moreover, since the lease between the parties did not call for GEX itself to indemnify Elul against liability claims, but rather to provide insurance in favor of Elul therefor, the Second Circuit's conclusion that Elul was required to assert as a compulsory counterclaim against GEX the latter's failure to obtain the insurance presupposes that Elul had knowledge, within 20 days of the service upon it of

GEX's Summons and Complaint, that the promised insurance was not in fact in effect. Neither District Judge Glasser nor the Second Circuit made a finding that Elul was aware of GEX's failure during that time frame; on the contrary, the record abundantly reflects Elul's understanding that such coverage was indeed in force.

The Second Circuit's reading of the compulsory counterclaim rule makes it preclusive on a defendant who has failed to assert a counterclaim even if it was unaware, and entirely justified in being unaware, that such a counterclaim existed. Elul respectfully suggests that such a reading of the compulsory counterclaim rule is clearly violative of the Fifth Amendment to the United States Constitution. The Second Circuit's decision was handed down

notwithstanding the fact that even as late as June 1992, when GEX filed its brief to the Second Circuit, GEX did not concede that it had failed to obtain the insurance as agreed, arguing instead in its brief that there was no evidence that it had failed to obtain the coverage called for in the lease. In fact, however, Magistrate Caden disallowed any evidence on the issue at the inquest.

In this connection, the decision in *Peter Fabrics, Inc. vs. S. S. Hermes*, 765 F.2d 306 (2d Cir. 1985) (Friendly, *J.*), is instructive. In *Peter Fabrics*, the third-party plaintiff made claim for damages against the third-party defendant, which claim the third-party defendant successfully resisted. It was only at trial that an agreement obligating the third-party

plaintiff to indemnify the third-party defendant surfaced, having been produced by counsel for the third-party plaintiff. Counsel for the defendant then advised the Court of his ignorance of the contract as well as the indemnity provision.

Following the trial and dismissal of the third-party complaint, the Trial Court granted leave to the third-party defendant to amend its answer to incorporate a counterclaim for indemnity as permissive, Fed. R. Civ. P. 13(b). In granting the motion, the Trial Judge took the position that the claim for indemnity had not matured until the primary claims had been resolved. *Peter Fabrics* is direct authority for the proposition that a claim for indemnity is not matured until the occasion for indemnity arises—at

least in circumstances where the party who would assert it had no knowledge at the time he served his answer.

In the instant case, Elul's claims against GEX for breach of the insurance clause of the lease did not mature for indemnity purposes until judgment was entered by the District Court in April 1992. *See, also, Montgomery Elevator Co. vs. Building Engineer Services Co.*, 730 F.2d 377 (5th Cir. 1984); *Reynolds vs. Hartford Accident and Indemnity Company*, 278 F. Supp. 331 (S.D.N.Y. 1967).

There can be no question that under the law of New York, GEX's failure to furnish the $1 million insurance coverage for the benefit of Elul as provided by its lease made GEX itself Elul's insurer. *Kinney vs. G.W. Lisk Co.*, 76 N.Y.2d 215, 557 N.Y.S.2d 283

(1990); *487 Elmwood Inc. vs. Hassett, et al.*, 161 A.D.2d 1171, 556 N.Y.S.2d 425 (4th Dept. 1990); *Tibbetts vs. IBM*, 161 A.D.2d 581, 551 N.Y.S.2d 160 (2d Dept. 1990); *Jensen vs. Chevron Corp.*, 160 A.D.2d 767, 553 N.Y.S.2d 485 (2d Dept. 1990). *See, also*, Judge Glasser's Memorandum and Order dated July 29, 1991 at 10 n.3 at 62a.

III. **THE REFUSAL TO MODIFY THE CONDITIONS FOR VACATUR OF THE DEFAULT DEPRIVED ELUL OF ITS CONSTITUTIONAL RIGHT TO A DAY IN COURT.**

The United States Constitution provides protection against a party being deprived of property without Due Process of Law. Denial of a day in Court to a defendant to prove what is admittedly a meritorious defense for failure to comply with a Court Order with which compliance is impossible is a violation of that party's Constitutional

rights because it is deprived by operation of the default judgment of its property. Many cases support this view. *See, e.g., Hammond Packing Co. vs. State of Arkansas*, 212 U.S. 322, 53 L.Ed. 530, 29 S.Ct. 370 (1908); *Hovey vs. Elliot*, 167 U.S. 409, 42 L.Ed. 215, 17 S. Ct. 841 (1897); *Logan vs. Zimmerman*, 455 U.S. 422, 71 L.Ed. 2d 265, 102 S. Ct. 1148 (1983). In *Thorpe vs. Thorpe*, 364 F.2d 692 (C.A.D.C. 1966), the Court reversed a bond requirement imposed by as a condition to vacating a party's default upon a showing that the defaulted party was unable to comply with the condition imposed. The Court stated in pertinent part at 695:

> If appellant's claim that he simply is unable to comply with a condition imposed is true, serious questions are raised, questions having an aura of denial of due process of law. *See Societe*

> *Internationale, etc., vs. Rogers*, 357 U.S. 197, 209-210, 78 S. Ct. 1087, 2 L.Ed. 2d 1255 (1958), where the Supreme Court stated, in another context, that imposition of an 'impossible' condition of a litigant's right to a trial on the merits raises Constitutional difficulties * * *

These authorities are especially applicable here, since the District Court refused to even consider Elul's claim of that compliance would be impossible or to direct that a hearing be conducted on that issue or to consider Elul's willingness to furnish adequate alternate security, an offer which the Second Circuit accepted as a condition to staying enforcement of the District Court's judgment pending its consideration of Elul's appeal.

Concededly, a Court has the power to refuse to vacate a default in a proper case. Such a case might be where

the party in default lacks a meritorious claim or defense (here Magistrate Caden observed that it appeared Elul had a meritorious defense) or has repeatedly been guilty of willful contumacious conduct. Similarly, it cannot be denied that a Court has the power to impose terms as a condition to an Order vacating a party's default. However, where the party in default admittedly has a meritorious claim or defense, and the default has not been *found* to have been willful, deliberate or contumacious, the imposition of terms which in a practical sense cannot be complied with, resulting in a party's denial of his day in Court and consequential deprivation of property, clearly violates that party's Constitutional rights, especially where the party in default is a defendant and

the monetary sums involved are relatively substantial. This is such a case.

CONCLUSION

For all of the foregoing reasons, a Writ of Certiorari to the Second Circuit should be granted and a stay of enforcement of the judgment of the United States District Court for the Eastern District of New York should issue pending consideration on the merits of Elul's appeal to this Court.

Dated: New York, New York
October 30, 1992

Respectfully submitted,

NOEL W. HAUSER, *Of Counsel*
Stephen H. Penn & Associates
Attorneys for Elul Realty

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 1954--August Term 1991
(Argued: July 14, 1992 Decided: August 24, 1992)
Docket No. 92-7545

GREYHOUND EXHIBITGROUP, INC.,
Plaintiff-Appellee,

--v.--

E.L.U.L. REALTY CORP.,
Defendant-Appellant,

ANTHONY GALLINA d/b/a GALLINA SPRINKLER SYSTEMS, and A. GALLINA SPRINKLER SYSTEMS and A. GALLINA HEATING AND MECHANICAL SPRINKLER CORP.,
Defendants.

Before:
ALTIMARI, MAHONEY, and WALKER,
Circuit Judges.

Appeal from the final judgment of the United States District Court for the Eastern District of New York, Honorable I. Leo Glasser, *Judge*, substantially adopting Magistrate Judge John L. Caden's report and recommendation and awarding plaintiff $1,496,425.82 in damages. The sum was calculated by means of a post default judgment inquest conducted in the course of plaintiff's action for property and other damages suffered as a result of a fire in defendant's warehouse.

Affirmed.

Judge Altimari concurs in part and dissents in part in a separate opinion.

KENNETH A. BLOOM, NEW YORK, NEW YORK
(Douglas B. Lang, Cozen and O'Connor,
of counsel), for *Plaintiff-Appellee.*

NOEL W. HAUSER, NEW YORK, NEW YORK
(Stephen H. Penn & Associates, of counsel),
for *Defendant-Appellant.*

WALKER, *Circuit Judge:*

This is an appeal from the final judgment of the

United States District Court for the Eastern District of New York, Honorable I. Leo Glasser, *Judge*, adopting the report and recommendation of Magistrate Judge John L. Caden. The case involves plaintiff-appellee's, Greyhound Exhibitgroup, Inc. ("GEX"), claim for damages allegedly caused by the defendant-appellant's, E.L.U.L. Realty Corp. ("ELUL"), negligence in conjunction with a warehouse fire. During the relevant period, GEX was a tenant in ELUL's warehouse. The particular dispute before us stems from the fact that ELUL defaulted in this action by failing to timely answer GEX's complaint. Upon the district court's entry of default against ELUL, the case was referred to the magistrate judge to conduct an inquest into the actual amount of financial injury that GEX suffered. *See* 28 U.S.C. § 636(b)(2); Fed. R. Civ. P. 53. At the close of the inquest, the magistrate judge recommended to the district court that ELUL be ordered to pay GEX $1,496,425.60 in damages. The district court adopted the magistrate judge's report and recommendation substantially in its entirety, and

entered judgment against ELUL for $1,496,425.82, along with costs and interest at the New York State statutory rate of 9%.

On appeal ELUL raises a host of issues, all of which we find to be without merit.

BACKGROUND

This litigation has an extremely knotted procedural and factual history which we need not fully untangle in order to address the issues raised on this appeal. The following discussion will suffice for the purposes of our analysis.

GEX is a Delaware corporation, with its principal place of business in Elk Grove Village, Illinois. It is engaged in the production, assembly and storage of exhibits used in trade sales. ELUL is a New York corporation, with its principal place of business in Brooklyn, New York. Among other properties, ELUL

owns and operates a warehouse (the "warehouse") located at 14 Whale Square, Brooklyn, New York. In January 1983, the parties entered into a lease agreement whereby GEX rented a substantial portion of the warehouse in which to conduct its business. On February 13, 1988, a fire broke out on the premises causing considerable property damage to GEX and other tenants.

In September 1988, GEX commenced this diversity action against ELUL, and others, alleging, *inter alia*, that the fire damage it suffered resulted from ELUL's negligent failure to maintain the warehouse's sprinkler system in good working order. GEX sought $1,500,000 in compensatory damages. On November 22, 1988, after ELUL failed to timely appear, answer, or otherwise make a motion with respect to GEX's complaint, the district court adjudged ELUL to be in default and ordered that an inquest be scheduled in order to determine the appropriate damage

award. Over four months later, on April 12, 1989 ELUL moved the district court to vacate its entry of default. The district court referred the question of vacatur to Magistrate Judge Caden for a report and recommendation.

On September 12, 1989, Magistrate Judge Caden entered an order and recommendation requiring that ELUL give written notice to all parties regarding any change in status as to ELUL's ownership or encumbrance of the warehouse property, and recommending that the default be set aside upon that condition. GEX filed objections to the recommendation. The district court was informed that ELUL had, in bad faith, violated the recommendation's notice condition by mortgaging the warehouse property for an additional $4.5 million on January 18, 1990 without advising either the court or GEX. Accordingly, the district court recommitted ELUL's vacatur motion to Magistrate Judge Caden for further consideration.

Upon reconsideration, the magistrate judge found that:

> The history of this case leaves little room for doubt that an unconditional vacatur would provide [ELUL] with an opportunity for fraud and could seriously prejudice [GEX]. The red flag of caution is amply supported by the combination of [ELUL's] consistent failure to observe court-imposed deadlines, the evidence of its attempts to secrete or dissipate a substantial asset, and the extended discourse over the existence and extent of insurance.

Nevertheless, Magistrate Judge Caden determined that ELUL should have the opportunity to litigate this sizeable claim on the merits. So as to allay his concern that GEX's ability to collect on any potential judgment might be prejudiced by ELUL's intervening actions, on July 23, 1990, he recommended that the entry of default be vacated upon the condition that ELUL post a $1 million bond within thirty days after issuance of the district court's order. By order dated November 7, 1990, the district court adopted Magistrate Judge Caden's recommendation.

Consistent with its previous conduct, ELUL failed to timely post the $1 million bond. In a letter dated December 13, 1990, ELUL asserted, *inter alia*, that it was unable to satisfy the bond requirement. On March 20, 1991, the district court denied ELUL's application for relief from its prior order requiring ELUL to post bond, entered judgment for GEX, and again ordered that an inquest be held to set plaintiff's damages. In what had become a familiar refrain, ELUL moved to vacate the district court's March 20th order. The district court reiterated the magistrate's findings in stating that:

> [I]t is readily apparent that Elul holds little regard for rules of civil procedure and for orders of the court. The court lacks confidence that Elul would observe an order to maintain the status quo. A vacatur would simply provide Elul with an opportunity for further wrongdoing, at the expense of GEX.

The court thereupon denied that ELUL's motion to vacate its entry of default judgment.

In December 1991, Magistrate Judge Caden conducted an inquest to assess GEX's damages. He received evidence regarding the costs that GEX incurred as a result of fire damage to trade exhibit works under construction, to supplies, goods and other materials, and to rental properties, as well as additional freight and storage charges that flowed from the loss of warehouse space. During the inquest, ELUL attempted to introduce evidence regarding comparative negligence of GEX that allegedly contributed to the warehouse fire. Furthermore, ELUL tried to argue that any damage award should be generally off-set by the $1 million amount of fire insurance which GEX was contractually obligated to provide under the lease but failed to obtain, and, more specifically, that the award for additional freight and storage costs should be off-set by the $250,000 in rental payments that GEX withheld from ELUL after the fire. ELUL contended that these factors

should be considered in mitigation of damages.

The magistrate judge refused to consider any evidence with regard to ELUL's proposed set-offs. Upon conclusion of the inquest, he recommended to the district court that ELUL pay GEX $1,496,425.60 in damages. On April 22, 1992, the district court adopted the magistrate's report and recommendation substantially in its entirety (merely correcting a slight mathematical error), and entered final judgment against ELUL in the amount of $1,496,425.82. ELUL moved in the district court to stay the enforcement of GEX's judgment pending appeal, which motion was denied. Ordering that ELUL post a $200,000 supersedeas bond, as well as furnish a note and supporting mortgage on the property to GEX for the amount of the judgment, a panel of this Court stayed its enforcement. This appeal followed.

DISCUSSION

The core of ELUL's argument on appeal is that during the post-default inquest, both the magistrate judge and the district court erroneously refused to consider evidence in "mitigation of damages." ELUL contends that GEX's: (1) alleged comparative negligence with respect to the warehouse fire; (2) failure to provide fire insurance as required by lease; and (3) withholding of rental payments, represent valid set-off claims regarding the extent of GEX's damages and, thus, should have been addressed by the court at the inquest. In response, GEX argues that ELUL is merely attempting to reopen the question of its substantive liability, which had been definitively closed by ELUL's failure to answer its complaint. We believe that the rule governing the scope of damage mitigation at a post-default inquest is not as clear cut as either ELUL or GEX would have it.

While a party's default is deemed to constitute a concession of all well pleaded allegations of liability, it is not considered an admission of damages. *See Flaks v. Koegel*, 504 F.2d 702, 707 (2d Cir. 1974); Fed. R. Civ. P. 8(d). Damages, which are neither susceptible of mathematical computation nor liquidated as of the default, usually must be established by the plaintiff in an evidentiary proceeding in which the defendant has the opportunity to contest the amount. *See Flaks*, 504 F.2d at 707; *see also U.S. v. DiMucci*, 879 F.2d 1488, 1497 (7th Cir. 1989); *cf.* Fed. R. Civ. P. 55(b)(2). The question before us now is whether and to what extent at a post-default inquest, a defaulting party may seek to mitigate damages by interposing set-off claims.

1) GEX's *Comparative Negligence*

Concerning the scope of damage recovery pursuant to a default judgment, we have stated that:

> The outer bounds of recovery allowable are of course measured by the principle of proximate cause. The default judgment did not give [plaintiff] a blank check to recover from [defendant] any losses it had ever suffered from whatever source. It could only recover those damages arising from the acts and injuries pleaded and in this sense it was [plaintiff's] burden to show "proximate cause." On the other hand, there was no burden on [plaintiff] to show that any of [defendant's] acts caused the well-pleaded injuries, except as we have indicated that it had to for the purpose of establishing the extent of the injury caused [plaintiff], in dollars and cents.

Trans World Airlines, Inc. v. Hughes, 449 F.2d 51, 70 (2d Cir. 1971), *rev'd on other grounds*, 409 U.S. 363 (1973).

ELUL reads our statement in *Hughes* to mean that "default or not, a plaintiff must show that the actions of the defendant were the proximate cause of the damages claimed by the plaintiff." ELUL's argument continues that because New York law (which presumably controls the outcome of this diversity case) permits the apportionment of damages based upon the percentage of culpability attributable to each party, *see* N.Y. Civ. Prac. L. & R. 1411

(McKinney 1976 & Supp. 1992), it should have been allowed at the inquest to prove GEX's relative fault with respect to the warehouse fire, and mitigate its damages accordingly. Judge Altimari, in his dissent from this portion of the majority opinion, adopts ELUL's argument. We think that both ELUL and the dissent read *Hughes* too broadly.

There is a categorical distinction between the element "proximate cause," as it pertains to the assignment of liability in the first instance, and "proximate cause" as it relates to the ministerial calculation of damages in the context of a default judgment. With regard to lability, the concept of proximate cause supplies the legal nexus between act and injury, and provides a necessary basis for awarding compensation. Where it is properly alleged in a complaint, proximate cause--going to liability--is completely and irrefutably established upon the defendant's

default. *See Flaks*, 504 F.2d at 707; *see also Benny v. Pipes*, 799 F.2d 489, 495 (9th Cir. 1986), *cert. denied*, 484 U.S. 870 (1987); Fed. R. Civ. P. 8(d). However, as employed in *Hughes*, the concept of proximate cause was merely used to set the limits of recovery according to the injuries that were conceded by default. Thus, in the *Hughes* context, the application of proximate cause presumes that liability has been established, and requires only that the compensation sought relate to the damages that naturally flow from the injuries pleaded. 449 F.2d at 70.

In its complaint, GEX sufficiently alleged that ELUL's negligence was the proximate cause of the fire damage. Those allegations were deemed admitted upon ELUL's failure to timely answer. ELUL's contention, that it should have been permitted to introduce evidence of GEX's comparative negligence, effectively contests settled issues of liability, i.e., who in fact caused the fire damage. If

accepted, ELUL's position would undermine both our decision in *Hughes* as well as the general policy governing default. To permit ELUL to argue comparative fault under the guise of damage mitigation now, at the inquest stage of the proceedings, would deny GEX the benefit of Rule 8(d). *But cf. Fehlhaber v. Indian Trails, Inc.* 425 F.2d 715, 717 (3d Cir. 1970) (where third-party complaint, *inter alia*, requested the court to determine relative fault, default by third-party defendant did not preclude the court from assessing damages according to comparative negligence).

2) GEX's *Failure to Acquire Fire Insurance*

According to ELUL, GEX breached its lease obligation to furnish $1 million in fire insurance. Citing New York law, *see, e.g., Kinney v. G.W. Lisk Co.*, 76 N.Y.2d 215, 219, 557 N.Y.S.2d 283, 285-86 (1990), ELUL claims that GEX is liable for the amount of insurance that it failed to provide and, as a result, the district court should

have off-set GEX's damage award by $1 million. GEX responds that, post-default, ELUL was procedurally barred from raising a claim for an insurance set-off. We agree with GEX.

The essential facts concerning GEX's alleged failure to indemnify ELUL by supplying fire insurance were " 'so logically connected [to GEX's claim against ELUL for fire damage] that considerations of judicial economy and fairness dictate[d] that all the issues be resolved in one lawsuit.' " *United States v. Aquavella*, 615 F.2d 12, 22 (2d Cir. 1979) (quoting *Harris v. Steinem*, 571 F.2d 119, 123 (2d Cir. 1978)). On this score, ELUL's claim against GEX was a compulsory counterclaim. *See id.*; Fed. R. Civ. P. 13(a). By failing to assert it in a timely responsive pleading, ELUL is now foreclosed from raising it in any subsequent proceeding--including the post-default damages inquest presently under review. *See Taylor v. City of*

Ballwin, 859 F.2d 1330, 1333 n.7 (8th Cir. 1988) ("By choosing not to respond, [defendants] will not now be heard to deny this claim; nor will they be allowed to raise a counterclaim for set-off."); *Cateret Sav. & Loan Ass'n v. Jackson*, 812 F.2d 36, 38 (1st Cir. 1987) ("when a defendant is defaulted for failure to file a pleading, the default applies to whatever the party should have pleaded"); 6 C. WRIGHT, A. MILLER & M. KANE, FEDERAL PRACTICE AND PROCEDURE § 1417 (1990).

3) GEX's *Additional Freight and Storage Costs*

As part of its overall damage award, the district court ordered ELUL to pay GEX $90,857.44 for certain freight and storage costs incurred as a result of GEX's loss of warehouse space. At the inquest, the magistrate judge refused to consider ELUL's claim that GEX had already made itself whole in this regard by reducing its warehouse

rental payments. ELUL argues that the district court's award reimbursing GEX for these costs effectively granted GEX partial double recovery. While we hold that ELUL's default did not deny it the right to assert its claim for withheld lease payments against GEX, we agree with the district court's decision to defer consideration of this claim until the disposition of the separate landlord/tenant action commenced by ELUL.

In asserting its right to a set-off for withheld lease payments, ELUL is not seeking to litigate issues of liability that were determined in GEX's favor as a result of the default. Rather, ELUL proffered the evidence at issue in order to establish that GEX had mitigated its freight and storage cost damages by withholding lease payments that GEX was contractually obligated to make to ELUL under the lease. Because the evidence of lease payments allegedly owed and not paid by GEX concerned issues of damages--

not liability--Rule 8(d) does not preclude ELUL from asserting and the district court from considering this evidence at the inquest. Indeed, if the district court's decision to refuse to consider evidence of alleged withholdings by GEX foreclosed ELUL's ability to assert its right to recover withheld lease payments from GEX, the decision would have been in error. GEX bore the burden of proving "in dollars and cents" each item of damage it claimed, *Hughes*, 449 F.2d at 70, and ELUL had a right to proffer evidence rebutting each damage claim, including by introducing evidence of mitigation of damages by GEX.

However, ELUL has not lost its ability to assert its alleged right to payments under the lease as a result of the district court's decision to deny consideration of the set-off claim. The district court's decision to deny any set-off was premised upon the fact that ELUL has independently asserted its lease payment claim in a separate pending

landlord/tenant action against GEX. For reasons of efficiency, the district court chose to defer consideration of ELUL's alleged right to the withheld lease payments until hearing the lease-related action. *Greyhound Exhibitgroup, Inc. v. ELUL Realty Corp.*, No. CV-88-3039, slip op. at 7 (E.D.N.Y. May 11, 1992). The district court apparently was concerned that resolution of ELUL's lease-related claim might involve consideration of a range of factual and legal issues unrelated to GEX's tort claims and thus unduly delay disposition of this action. Moreover, the outcome of the landlord/tenant action could undo any set-off ELUL might achieve were it permitted to assert its claim for lease payments at the inquest.

We believe that the district court is in the best position to determine the most efficient and expeditious means of resolving the procedurally and factually complicated litigations arising from the warehouse fire. And, given that

ELUL remains free to assert--and GEX remains free to challenge--the withheld lease payments claim in the pending landlord/tenant action, we can find no error in the district court's refusal to consider the lease payments claim at the inquest.

CONCLUSION

While at times the repercussions of default may seem harsh, "[t]he purpose behind default jdugments. . .is to allow district courts to manage their dockets efficiently and effectively." *Merrill Lynch Mortgage Corp. v. Narayan*, 908 F.2d 246, 253 (7th Cir. 1990). If we were to allow a defaulting party to contest liability and interpose general set-offs at the damages inquest, we would eviscerate the rule governing defaults, and for all practical purposes deprive the district courts of this important case management tool. On the other hand, a defaulting party must be permitted to contest the actual compensatory

amount claimed with respect to any particular item of damages, inccluding through proof of mitigation of damges. ELUL--through its claim for withheld lease payments--may be able to establish that GEX mitigated its freight and storage cost damages. And this damage-related claim was not foreclosed by ELUL's default. However, the district court acted within its discretionary power to manage its docket in withholding consideration of ELUL's lease payments claim until hearing of ELUL's pending landlord/tenant action.

We have considered all of ELUL's other arguments and find them to be without merit.

Affirmed.

ALTIMARI, *Circuit Judge*, concurring in part and dissenting in part:

It is clear that a default judgment has the effect of

conclusively establishing two elements of a plaintiff's case: whether a defendant's acts or omissions were negligent and whether those acts or omissions proximately caused *an* injury to a plaintiff. *See Trans World Airlines, Inc. v. Hughes*, 449 F.2d 51, 69-70 (1971), *rev'd on other grounds*, 409 U.S. 363 (1973). However, *Trans World Airlines* was equally clear in holding that a default does not alleviate plaintiff's burden of establishing that the injury was the proximate cause of *all* of the damages claimed by the defendant. Id; *see also Fehlhaber v. Indian Trails, Inc.*, 425 F.2d 715, 717 (3d Cir. 1970) (holding that a default judgment did not preclude the court from assessing damages according to comparative negligence). Put differently, a default judgment establishes *whether* a plaintiff suffered damage; it does not, however, establish the *amount* of those damages. The holding in *Trans World Airlines* is both binding and sensible, but the majority pays

it no heed. Because the majority's opinion is at odds with binding circuit precedent, I must respectfully dissent from that portion of the majority's decision which holds that where the damages "naturally flow from the injuries pleaded", a default removes from a plaintiff the burden of establishing that the amount of damages claimed was proximately caused by the injury suffered.

As the majority indicates, the underlying action in this case stemmed from a fire on February 13, 1988, at a warehouse owned by appellant Elul Realty Cop. ("Elul"). Appellee Greyhound Exhibitgroup, Inc. ("GEX") was a tenant in the building, and suffered significant property damage as a result of the fire. In its complaint, GEX did not allege that Elul's negligence caused the fire. Rather, the complaint asserts that the fire spread as a result of Elul's negligence in maintaining a sprinkler system.

At the hearing on damages, the magistrate refused to

allow the Supervising Fire Marshall in attendance at the fire to testify in Elul's behalf. The Fire Marshall had previously submitted an investigative report in which he described how the fire originated through "horseplay" among a few of GEX's employees. In an affidavit, the Fire Marshall concluded that even if the sprinkler system had been fully operational it would have had a negligible effect in controlling the fire. As the Fire Marshall noted, the sprinkler head above the point of origin of the fire was in the roof. Therefore, according to the Fire Marshall, even if the sprinkler system had been fully operational, by the time sufficient heat had risen to activiate it, the fire would have already reached the flammable liquid stored by GEX, and the sprinkler system could not have controlled the fire. However, the Fire Marshall's testimony was deemed irrelevant by the magistrate, since it did not speak to the amount of damages caused by the fire.

The district court did not question the exclusion of this testimony; neither does the majority. Indeed, according to the majority, to permit the introduction of evidence of GEX's contributory negligence "effectively contests settled issues of liability, i.e. who in fact caused the fire damage." This statement makes clear that the majority's decision, by inflating the admission of liability to encompass damages as well as injury, has *sub silentio* relieved the plaintiff of the burden of proving "those damages arising from the acts and injuries pleaded", *Trans World Airlines*, 449 F.2d at 70, in direct contravention of *Trans World Airlines'* holding that a default judgment only proves "the fact of. . .the injury", not the extent thereof. *Id.* The end result of this compression is that the plaintiff is relieved of its burden of showing that the breach of the duty of care, for which defendant is liable, proximately caused the damages alleged. *See Trans World Airlines*, 449 F.2d at 70.

Elul's default established its liability only as to the fact of the injury alleged, not the extent of the damages proximately caused by that injury. *Id.* at 69. This is because when a defendant defaults, the "burden of establishing proximate cause is satisfied *as to liability* if proximate cause is adequately alleged in the complaint." *Id.* at 70 (emphasis in original). However, the default judgment did not relieve GEX of establishing that the injury proximately caused by Elul's negligence was in turn the cause of the "damages arising from the acts and injuries pleaded and in this sense it was [plaintiff's] burden to show 'proximate cause.'" *Id.* In other words, Elul's default established the existence of its liability, not the extent of its liability. *Id.* at 70; *see also* Restatement (Second) of Torts § 454 cmt b. (1965) (proof of proximate cause is necessary for the establishment of liability, as well as for the establishment of the amount of damages where liability is admitted).

Under *Trans World Airlines*, Elul's default precluded it from grounding its defense on an assertion that it properly maintained the sprinkler system. The default also established that Elul's negligent act proximately caused the fire to spread, which was the injury alleged. *Id.* at 70. However, the default judgment did not give GEX a "blank check" to recover damages "it had suffered from whatever source." *Id.* Consequently, GEX had the burden of proving that all of the damages alleged were proximately caused by the spread of the fire, which by reason of the default was admitted to have been the proximate result of Elul's negligent acts or omissions. In order to meet this burden, GEX should have been required to prove that none of the damages was proximately caused by the negligence of its own employees in starting the fire or in its negligent storage of flammable materials.

Because the district court failed to require GEX to

submit such proof, and in fact denied Elul the opportunity to submit proof that the damages were not the sole result of the injury for which it was liable, I would vacate the award and remand for a determination of the extent to which Elul's negligence proximately caused the damages suffered by GEX.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

----------X

GREYHOUND EXHIBITGROUP, INC.,
Plaintiff,

-against-

MEMORANDUM AND ORDER
CV-88-3039

ELUL REALTY CORP. et al.,
Defendants.

----------X

GLASSER, United States District Judge:

Plaintiff Greyhound Exhibitgroup ("GEX") obtained a default judgment against defendant Elul Realty ("Elul") for damages arising out of a fire at GEX's Brooklyn premises. In October 1991, this court appointed Magistrate Judge Caden as special master, pursuant to 28 U.S.C. § 636(b)(2) and Fed. R. Civ. P. 53, for the determination of damages.

The magistrate held hearings on December 2, 3, 4, and 11, 1991. Voluminous compilations of exhibits -- at least four volumes worth, each roughly the dimensions of the

Manhattan phone directory -- were received, and numerous witnesses provided sworn testimony. On February 21, 1992, Magistrate Judge Caden issued a report and recommendation that plaintiff GEX be awarded $1,496,425.60 of the requested $2,438,810.91 in damages. Both parties entered objections to various components of the recommendation, which are considered in turn below.

DISCUSSION

At the outset, it is essential to note the governing standard of review. This court referred the issue of damages to Magistrate Judge Caden under Rule 53, which sets forth the contours of special master referrals. Specifically, subsection (e)(2) states that in a non-jury action, "the court shall accept the master's findings of fact unless clearly erroneous." A determination "is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the

definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 384, 395 (1948).

Accordingly, the court accords substantial deference to the magistrate's findings in considering the objections discussed below.

I. Plaintiff's Objections

A. Category IX: Clean-Up of Customers' Property

Plaintiff GEX alleged $300,000 in damages for the cleaning of customers' property (stored by GEX at their premises) damaged by smoke and soot in the fire. On behalf of GEX, Victor Ruggiero testified to his belief that roughly 1,500 customer cases in storage at the time of the fire were damaged. Tr. 14.[1] Based on a sample of 25 cleaned cases, Ruggiero had previously estimated the cleaning cost per case at $100. Exh. 98. Ruggiero also testified that the cleanup of an unspecified number of cases

[1]Citations to the record of the December 1991 inquest are abbreviated as "Tr."

took place over nearly a year, and he revised his estimate of the cost to $200/case during testimony, based on such factors as customer returns of inadequately cleaned displays.

The magistrate denied this component of the damages request in its entirety. He noted specifically that aside from the $100 cleanup estimate breakdown, GEX produced no documents substantiating this claim. Specifically, the magistrate observed that the number of cases was suggested only by Ruggiero's recollection; that the $100/case cost was based on a small sample relative to the alleged total; and that no support aside from Ruggiero's conclusory statement supported the $200 figure.

This court accepts the magistrate's recommendation. While GEX did offer evidence in support of the claim, the proof is hardly of the convincing character necessary for

rejection of the magistrate's finding.[2] The mere fact that GEX's evidence was "credible", Plaintiff's Obj. ¶ 3, does not oblige the finder of fact of fact to credit them. Because any court could choose either to accept or discount the slim evidence adduced by GEX on this issue, this court cannot conclude that the finding below constitutes clear error.

B. Category X: Improvements and Betterments

Plaintiff GEX also alleged $193,514 in damage to improvements made by GEX to its Brooklyn facility. GEX's witness John Mansfield testified that GEX had installed, among other things, carpeting, ceilings, walls, wallpaper, partitions, shop bathrooms, and an employee locker room. Tr. 200-02. A detailed post-fire estimate of the cost to restore the premises to their prior condition was prepared by C.J. Rubino & Co., Exh. 13A; that estimate is the basis for GEX's claim for $193,514.

---

[2]The court is aware, as was the magistrate, that the fire itself necessarily left GEX in a difficult position regarding the production of proof. At the same time, however, the court cannot be expected to credit allegations made without any substantial support or corroboration, whether by documentary evidence or other witness testimony.

Magistrate Judge Caden denied this component of damages in its entirety. His recommendation is based on the fact that most of the repair work detailed in the Rubino report was not actually performed, and that the minimal repairs actually done after the fire were possibly included as losses in other categories. Tr. 203-09. GEX contends that this finding is irrelevant, and argues that damages should be measured by the value of the loss itself rather than by the extent of subsequent restoration.

While GEX raises an interesting point, the magistrate's finding should be accepted. The subject matter of this category -- improvements to the premises -- is conceptually distinct from GEX's works in process, materials, and other property. Paragraph 3 of the lease for the premises, Def. Exh. I, states that

> All fixtures and all paneling, partitions, railings, and like [illegible], installed in the premises at any time, either by Tenant or by [illegible] in Tenant's behalf, shall, upon installation, become the property of Landlord and shall remain upon and be surrendered with the demised premises .

The term of the original five-year lease ran from January 1, 1983 to December 31, 1987; rider paragraphs 43 and 44 provided GEX with rights to 2 three-year renewals to the end of 1993. The fire took place on February 13, 1988; as GEX's present submission concedes, Elul terminated GEX's lease legally in June 1988.

Under these circumstances, GEX is not entitled to recover for this property damage. In a similar case involving landlord-tenant liability for fire damage in a commercial building, the First Department made the following observations:

> The second counterclaim to recover $14,000 for improvements allegedly made by the tenant, should have been dismissed since the lease was terminated in accordance with its provisions under the decision of the Appellate Term, and on such termination the alleged improvements by the terms of the lease became the property of the owner.

Airway Supermarkets, Inc. v. Santone, 102 N.Y.S.2d 649, 650 (1st Dep't 1951).

II. Defendant Elul's Objections

As an initial matter, defendant Elul raises several legal objections to the proceedings below. All such objections should be denied.

First, Elul contends that under Rule 8(d) its default does not free GEX from the burden of showing that Elul's actions were the proximate cause of GEX's injury. Elul's contention has no merit, and must be rejected; by defaulting, Elul has (under the express terms of Rule 8(d)) conceded all matters raised in the complaint save the amount of damages. The only requirement imposed on GEX is to establish that the specific injuries alleged were caused by the fire for which Elul has implicitly assumed responsibility. On this point, the record of the magistrate's inquest is replete with proof that the damages alleged and awarded were caused by the fire.

Elul also argues that GEX's apparent failure to obtain

a $1,000,000 insurance policy for negligence, as specified in paragraph 49 of the lease agreement, requires a reduction for failure to mitigate damages. While GEX argues that this clause is invalid under New York General Obligations Law, this court need not reach a decision on that issue. That questions awaits resolution in Elul's separate lawsuit against GEX; the present proceeding is concerned solely with the damages sustained by GEX as a result of Elul's conceded negligence.

On this same point, Elul argues that this court's decision of July 29, 1991, denying Elul's motion to vacate the default against it, expressly countenances consideration of the indemnity clause of lease paragraph 49. Elul points specifically to page 10, note 3 of that decision, which does not support Elul's claim. A careful reading of that footnote makes clear that "Elul's contention . . . implicates the amount of damages, not liability . . . ." At issue then was

the supposed unfairness of requiring Elul to post a $1,000,000 bond, when Elul anticipated liability less than that amount. What "may be argued at the damages inquest to be held by this court" is the amount of damages itself, rather than the validity of paragraph 49, which may or may not be a legitimate basis for relief in Elul's separate action.

A. Category I: Work in Process

Elul asserts that the award of $307,465 in this category is predicated on improper methods of calculating the extent of loss. Specifically, Elul asserts that actual cash value, rather than cost of replacement, is the appropriate measure of damages.

This court adopts the magistrate's findings. As the magistrate noted, GEX provided extensive documenation supporting the excess cost of completing each job occasioned by the fire's damage. See Exhs. 2, 3, 14, 106-14. Both GEX and the magistrate calculated the total

damage on each job by aggregating total costs, and then comparing that cost to the original job estimate provided to the customer. GEX also provided testimony that such estimates were extremely accurate projections of actual costs. Tr. 306.

Given this method, it cannot be said that GEX's damages were improperly calculated. Elul's contentions notwithstanding, GEX is entitled to be made whole on its loss; in this case, such redress necessarily incorporates the excess costs, and the profit, associated with completing a pending order.

Elul specifically attacks Exhibit 111, which supports GEX's claim for roughly $216,000 in connection with the "Olympus Camera" job. Although Elul claims to detect no rhyme or reason to this exhibit, this court's examination of the calculations on the face of page 1 of that document leaves it in no doubt that GEX did indeed incur such excess

costs as a result of the fire.

B. Category II: Supplies, Goods, & Other Materials

GEX alleged damages of $255,344 in this category. The magistrate awarded the amount of $231,491; this figure was based on a recalculated total of $261,716 less $15,000 improperly included for contingent losses (Exh. 139 p. 2) and $15,225 in accounting errors (Exh. 139 p. 3). The remainder of the damages was supported by extensive documentation. Exhs. 12, 24, 25-54, 97, 139.

The magistrate's recommendation is adopted, as Elul's various objections to this component of the damages award are without merit. In particular, Elul argues that various summary sheets and replacement documents were improperly introduced as proof of loss. Defendant's attention is appropriately directed to Rules of Evidence 1004 and 1006.

C. Category III: Rental Properties

GEX requested $938,671 for damage sustained to materials rented (and infrequently sold) to customers for

display use. Because GEX's proposed figure reflected the actual selling price of the materials damaged (Exh. 5), and because GEX had no reasonable expectation of actually selling the goods, the magistrate awarded instead the total replacement cost of $552, 462. Exh. 5; Tr. 322-24.

Elul contends that the proper measure of damages was instead the actual cash value of the properties. Elul argues that at least some of the properties in question were well into their life of service, had apparently already produced substantial revenue, and were obsolete or in used condition. However, the extent and nature of these factors is not clear on the record; given the magistrate's ability to observe the testimony given, and his thorough review of the documents submitted, it cannot be said that his decision -- awarding GEX less than 59% of its asserted claim -- was clearly erroneous in this respect.

Finally, Elul contends (correctly) that several of the

properties listed on page 2 of Exhibit 5 were jointly owned by GEX with other parties. Elul alleges that in many instances the co-owners have initiated action against it and GEX for these proportionate shares, and that Elul is thereby exposed to double liability. However, this court is of the opinion that in any such separate action Elul may implead GEX for any amount of double liability. Accordingly, the magistrate's finding is adopted.

D. Category V: Overtime and Payroll

GEX provided proof of additional payroll costs of $82,936.49 during the inquest; subsequently, GEX asserted (in its post-inquest submissions) an extra $20,000 in newly discovered costs. The magistrate accepted only that portion proven at the inquest, and awarded the amount of $82,936.49.

Elul objects that this figure amounts to double counting. Specifically, Elul asserts that Exhibit 111 (the

above-mentioned "Olympus Camera" job) appears to include overtime costs and other excess payroll associate with the post-fire work performed at Chicago. While the exhibits themselves are not altogether clear on this point, GEX's post-inquest submissions demonstrate that its damage request (in the amount of $102,070.59) does not include costs allocated to other categories of damages. Pltff's. Proposed Findings of Fact at 19 n.4. In fact, the magistrate's report makes specific reference to this calculation.

Accordingly, the magistrate's finding is adopted.

E. Category VIII: Freight and Storage

GEX alleged $90,857.44 in damages incurred from transporting exhibits to, and storing them in, a New Jersey facility after the fire. The magistrate accepted this amount on the basis of extensive documentary proof. Exhs. 62-96; Tr. 184-92.

Elul contends that any such costs should be offset against GEX's conceded reductions in rent payment for the same periods. This contention is without merit; Elul remains free to contest this issue (along with the paragraph 49 indemnity clause) in its separate landlord-tenant action. The only relevant fact for the purpose of this proceeding is that GEX suffered injury in the amount of the magistrate's award, which this court adopts.

III

The magistrate's report and recommendation is adopted in its entirety. The Clerk of the Court is directed to enter judgment for plaintiff in the amount of $1,496,425.82,[3] along with the costs of this action, and interest at the New York statutory rate of 9%, according to the following schedule:

A. Work in Process: $307,465.00 in damages, accrued as of February 13, 1988, the date of the fire;

---

[3]This figure represents the sum of the damage components awarded by the magistrate. It corrects minor mathematical and transcription errors in part XII of the magistrate's report.

B. Supplies, Goods, and Other Materials: $231,491.00, accrued as of February 13, 1988;

C. Rental Properties: $552,462.00, accrued as of February 13, 1988;

D. Blueprints and Models: $18,700, accrued as of February 13, 1988;

E. Overtime and Premium Payroll: $82,936.49, accrued as of the reasonable intermediate date of February 26, 1988;

F. Storage Income: $78,929.25, accrued as of the reasonable intermediate date of August 13, 1988;

G. Cleanup - Miscellaneous: $179,255.24, accrued as of the reasonable intermediate date of March 1, 1988;

H. Freight and Storage: $90,857.44, accrued as of the reasonable intermediate date of September 1, 1988;

I. Salvage: A reduction of damages in the amount of $45,670.60, with a corresponding deduction for interest accruing thereon from March 9, 1988.

SO ORDERED.

Dated: Brooklyn, New York
April 22, 1992

I. LEO GLASSER, U.S.D.J.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

----------x

GREYHOUND EXHIBITGROUP, INC.
Plaintiff,

MEMORANDUM
AND ORDER
CV-88-3039

-against-

ELUL REALTY CORP., ANTHONY GALLINA d/b/a/ GALLINA SPRINKLER SYSTEMS and A. GALLINA HEATING & MECHANICAL SPRINKLER CORP.,
Defendants.

----------x

GLASSER, United States District Judge:

This case arose from a fire that occurred on February 13, 1988 at a warehouse located at 14 Whale Square, Brooklyn, New York. Plaintiff was a tenant in the building, which was owned by Defendant E.L.U.L. Realty Corp. ["Elul"], and allegedly suffered significant property damage as a result of the fire. Elul has moved, inter alia,

for an order vacating a default judgment signed on March 20, 1991. To decide the otucome of Elul's motion, it is necessary to review the procedural history of the case.

On September 30, 1988 Greyhound Exhibitgroup, Inc. {"GEX"] filed a complaint alleging $1.5 million in damages.[1] On Nobember 22, 1988 a default judgment was entered against Elul for failing to respond to the complaint. Approximately four months later, on April 12, 1989, Elul sought to vacate the judgment. While the motion was pending, the court held a number of conferences, during which Elul made several conflicting representations as to the amount of its liability insurance. At one conference Elul asserted that it had liability insurance in the amount of $500,000; at other conferences it stated the amount was $2 million and $3 million. Also while the motion was

[1]In a Report and Recommendation written by Magistrate Caden and adopted by Judge McLaughlin in a Memorandum and Order dated November 7, 1990, the amount of GEX's claimed damages was stated to be $6 million. That was an error because the complaint seeks recovery in the amount of $1.5 million.

pending, GEX asked for assurances that Elul would not sell, transfer or encumber the building until after the motion had been decided. An Elul officer, Samuel Weis, responded that the company had no intention to sell the Whale Square property. However, according to a real estate broker's affidavit submitted by GEX in answer to Weis' representation, the property was already on the market for sale. Despite these inconsistent representations, on September 12, 1989 Magistrate Caden recommended that the default judgment be set aside. He also ordered that Elul give written notice to all parties of any change in status as to ownership or equity respecting 14 Whale Square. Both parties appealed.

While the appeal was pending, plaintiff conducted a title search revealing that on January 18, 1990 a $4.5 million mortgage had been taken out on the Whale Square property, which had already been encumbered by a

subordinate mortgage in the amount of $3 million. Elul did not provide notice of the second mortgage, as required by Magistrate Caden. After learning about the new encumbrance, Magistrate Caden ordered Elul to provide a written report on the status of the property's mortgage. Elul did not comply with the order, nor did it provide a witness for a deposition that had been scheduled at that time. Soon thereafter, Judge McLaughlin recommitted the default issue to Magistrate Caden for reconsideration of his earlier recommendation.

On July 23, 1990 Magistrate Caden issued a Report and Recommendation in which he stated that "this is indeed a close case," but that "sound judicial policy favor[s] resolution of disputes on the merits." He recommended that the default be vacated on the condition that Elul post a $1 million bond thirty days after the district court issued its order. Magistrate Caden recommended the use of a bond as

a device to prevent further opportunity for fraudulent activity, in light of the history of the litigation.

Several parties filed timely objections to the Magistrate's report. Nonetheless, Judge McLaughlin adopted Magistrate Caden's report as his own decision and, in a Memorandum and Order dated November 7, 1990, ordered Elul to post the bond. More than thirty days later, in a letter to the court dated December 13, 1990, Elul asserted, inter alia, that it was unable to satisfy the bond requirement. On March 20, 1991, this court[2] denied Elul's application for relief from Judge McLaughlin's decision, entered a judgment of default on liability and scheduled an inquest on damages.

In the present motion Elul seeks to vacate the March 20 default judgment. It also seeks a modification of the bond requirement or, in the alternative, leave to appeal pursuant to 28 U.S.C. § 1292(b). Plaintiff cross-moves for

---

[2]Judge McLaughlin was appointed to the Court of Appeals for the Second Circuit and the case was reassigned.

sanctions pursuant to Rule 11, Fed. R. Civ. P.

DISCUSSION

A. Vacating the Default.

Elul's motion to vacate the default judgment was made pursuant to Rules 55(c) and 60(b), Fed. R. Civ. P. Rule 55(c) provides that "[f]or good cause shown the court may set aside an entry of default and, if a judgment by default has been entered, may likewise set it aside in accordance with Rule 60(b)." A threshold question in the present case is whether the court should rely on the standard of Fed. R. Civ. P. 55(c), which permits a court to set aside a default entry for "good cause shown," or on the stricter standard of Rule 60(b), which governs relief from a default judgment. The answer to this question turns on whether the March 20 order, denominated a "Judgment", is construed as default entry or as a default judgment.

Pursuant to Rule 55, once a defendant fails to file a

responsive answer, he or she is in default and an entry of default may be made by either the clerk or the judge. A default judgment may be entered by a clerk only if a claim is liquidated or, if a claim is unliquidated, by the judge after a hearing on damages. Thus, a default judgment can be entered only after damages have been determined. See Dow Chemical Pacific Ltd. v. Rascator Maritime, S.A., 782 F.2d 329 (2d Cir. 1986) (order denominated "Default Judgment" held not to be final because it expressly ordered inquest on damages; only thereafter would final judgment be entered); Jackson v. Beech, 636 F.2d 831, 835-36 (D.C. Cir. 1980) (Rule 60(b)'s standard applicable only after damage award became final and appealable). In the present case the March 20 order cannot be considered a final judgment pursuant to Rule 60(b) because the damages were unliquidated and had not been determined when it was entered. Indeed, an inquest on damages is currently

scheduled but has not yet been held. Accordingly, the lower standard of Rule 55(c) governs the outcome of the motion to vacate.

Federal Rule of Civil Procedure 55(c) provides that a court may set aside an entry of default for "good cause shown." To determine whether a default judgment should be set aside, courts in the Second Circuit must consider three factors: (1) whether the default was willful; (2) whether setting aside the default would prejudice the non-defaulting party; and (3) whether the defendant presented a meritorious defense. Brock v. Unique Racquetball and Health Clubs, Inc., 786 F.2d 61, 64 (2d Cir. 1986); Marziliano v. Heckler, 728 F.2d 151, 156 (2d Cir. 1984). A district court must explain its Rule 55 (c) ruling with explicit reference to the foregoing three criteria. Marziliano, 728 F.2d at 156. This court's analysis of the three factors follows.

1. Willfulness. Courts have held a default to be willful when a defendant knew about the complaint and failed to respond. Marziliano v. Heckler, 728 F.2d 151, 156 (2d Cir. 1984) (default held willful where defendant's attorney, without explanation, failed to inform the court about a stipulation extending defendant's time to respond). Willfulness has been found where the defendant fails to comply with the court's orders. See Ferraro v. Kuznetz, 131 F.R.D. 414, 419 (S.D.N.Y. 1990). Courts have also held the default to be willful when a lawyer neglects a case for an extended period of time. Walpex Trading Co. v. Yacimientos Petroliferos Fiscales Bolivianos, 109 F.R.D. 692 (S.D.N.Y. 1986).

In the present case Elul's failure to answer the complaint resulted in the entry of default on November 22, 1988. Elul's current counsel has alleged that the default occurred as a result of the negligence of Elul's previous

counsel. This excuse is not persuasive. It is undisputed that the summons and complaint were properly served on Elul's registered agent, who was an attorney. It is also undisputed that Elul's general counsel was aware of the commencement of the suit and could have filed a response to the complaint. Elul's explanation that the delay was caused by difficulty in contacting the appropriate insurance carrier is not convincing because Elul has not submitted any factual support for its allegations. As Magistrate Caden noted in his Report and Recommendation, Elul has not provided specific dates when it attempted to contact the insurer in an attempt to dispel the confusion, nor has Elul asserted that it sought an extension of time from GEX or the court.

This is not a case in which counsel acted with gross negligence, whereas the client acted with extreme

diligence. In such a case, a court might find that the client should not be held accountable for the attorney's conduct and that the client would be entitled to relief from a default. See, e.g., Vindigni v. Meyer, 441 F.2d 376, 378 (2d Cir. 1971) (counsel completely disappeared, client diligently tried to locate attorney to ascertain status of case, and relief granted); In this case, by contrast, Elul has offered no evidence showing that it acted diligently and responsibly in defending the present case. The court concludes that Elul's default was willful. See United States v. Cirami, 535 F.2d 736, 741 (2d Cir. 1976) (record revealed no gross negligence by counsel and no evidence of client diligence and, therefore, relief was denied).

2. Prejudice to Plaintiff. The Second Circuit has held that "delay alone is not a sufficient basis for establishing prejudice." Davis v. Musler, 713 F.2d 907, 916 (2d Cir.

1983). To establish prejudice, plaintiff must demonstrate that the delay will cause other types of harm, such as a loss of evidence, difficulty in discovery or a likelihood of fraud and collusion. See id.

The three-year history of the present case establishes that a vacatur would provide Elul with an opportunity for further wrongdoing, such as disobedience of court orders and rules of civil procedure. Elul's misdeeds and misrepresentations have been ongoing since the commencement of the case, when Elul offered contradicting statements as to the amount of liability insurance it carried: in approximately December 1988, it was believed that Elul had $500,000 in insurance; in February 1989 Elul represented that it had $2 million; in March 1989, the figure was said to be $3 million; and on August 31, 1989 Elul cited the $2 million amount. Later in the proceedings, despite assurances to the court that it would not sell or encumber the Whale Square property,

Elul in fact put the property on the market. Notwithstanding a court order to provide written notice to all parties in the event of a change in ownership or equity, Elul obtained a $4.5 million mortgage without notifying the court or the other parties. Elul also ignored the court's order to provide a written explanation of the status of the mortgage and failed to provide a witness at a scheduled deposition.

Most recently, Elul failed to comply with this court's bond requirement. Elul has attempted to excuse the last delinquency on the ground that it simply was not able to obtain the requisite funds. Elul's apparent good intentions are belied, however, by the fact that although Elul has known about the bond requirement since November 7, 1990, it has never attempted to amend the requirement through proper legal mechanisms. Elul's protest against the bond requirement by letter dated December 13, 1990,

without a formal motion, affidavit, or reference to legal authority did not conform to any rule of civil procedure. Moreover, it was untimely, because Elul submitted it after the 30-day period had expired.

Upon review of the entire record of this litigation, it is readily apparent that Elul holds little regard for rules of civil procedure and for orders of the court. The court lacks confidence that Elul would observe an order to maintain the status quo. A vacatur would simply provide Elul with an opportunity for further wrongdoing, at the expense of GEX.

3. Meritorious Defense. A party's defense may be deemed meritorious for default purposes if the defense raises a significant issue; a party need not establish the merits of the defense conclusively. Marziliano, 728 F.2d at 156. However, a defense that is merely superficial, conclusory or equivocal will not satisfy this prong of the test. Id. at 156-57.

Elul's defense in this case is that GEX was the party responsible for the fire, which originated in the portion of the warehouse rented by GEX. Elul conceded that the sprinkler system did not operate at the time of the fire, but alleged that the sprinkler was located in an area under plaintiff's exclusive control. "Under these circumstances," Elul stated in its motion papers, "it is fair to assume that if the trier of fact were to find Elul guilty of any negligence whatever, it would be far less proportionally to that of [GEX] itself." Memorandum of Law at 16. Elul did not, however, offer a shred of evidence in support of this "fair assumption" and it is not credible.[3]

---

[3]Elul argues that under the lease agreement GEX was required to obtain liability insurance to indemnify Elul for the first $1 million in damage caused by GEX. Elul contends that if, as GEX alleges, the fire caused damage in the amount of $1.5 million, then the $1 million bond requirement was unjust. After GEX's payment of the first $1 million in damages, Elul asserts it would be liable for significantly less than the amount of the bond. To the extent that Elul's contention has any merit, it implicates the amount of damages, not liability, and may be argued at the damages inquest to be held by this court.

In light of Elul's willfulness and the great risk of prejudice to GEX if relief from the default were granted, Elul's weak arguments on the merits do not persuade the court that relief from the default is justified. Elul's application to vacate the March 20 Judgment is hereby denied, pursuant to Federal Rule of Civil Procedure 55(c), because good cause has not been shown.[4]

B. Interlocutory Appeal

Elul has sought an order granting leave to appeal pursuant to 28 U.S.C. § 1292(b). Before certifying a question for interlocutory appeal under § 1292(b), a court must determine whether its order involves a controlling question of law as to which there is "substantial ground for difference of opinion," and whether an immediate appeal

[4]To the extent that Elul's motion seeks to vacate Judge McLaughlin's Memorandum and Order, the motion is denied. Four months ago, on March 20, 1991, Elul sought the same relief and this court denied that request. Elul has offered no new information or argument that the court finds persuasive.

will materially advance the ultimate termination of the litigation. C. Wright & A. Miller § 3930. In the present case, in light of Elul's consistent refusal to observe court orders and federal rules, the propriety of the default judgment on liability cannot seriously be disputed. In addition, granting leave to appeal would not expedite resolution of the case against Elul. On the contrary, an immediate appeal seems best calculated to materially delay such ultimate determination. Accordingly, Elul's request for certification of the issue of the default is denied.

C. Rule 11 Sanctions.

Plaintiff's cross-motion for sanctions is based on Elul's representation that it is not able to post the $1 million bond, as required by Judge McLaughlin's Memorandum and Order. GEX contends that that representation is so egregious it warrants sanctions under Rule 11, Fed. R. Civ.

P.[5] Plaintiff argues that Elul has $2.8 million in equity in the Whale Square property and that counsel for Elul admitted that Elul "has other assets." Plaintiff also states that Elul has not accounted for the $4.5 million mortgage proceeds.

Elul responds that it has no means of obtaining the $1 million bond. It asserts that the mortgage proceeds have been reinvested in the Whale Square property. Sam Weis, identified as an "officer" of Elul, stated in an affidavit that the company is not able to obtain financing from its primary lender, Republic National Bank, and furnished a letter denying Elul a letter of credit. He further stated that

---

[5]Rule 11, Fed. R. Civ. P., provides that the signature of an attorney on a pleading or motion constitutes a pledge that:

> to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.

Elul is prepared to offer the building as collateral for the bond, but represented that the building would not be acceptable to bonding companies.

When considering a motion for sanctions pursuant to Rule 11, the critical issue is "whether reasonable inquiry could have warranted the belief that the filing of this motion was justified" in fact and law. Virgin Atlantic Airways, Ltd. v. National Mediation Board, 132 F.R.D. 342, 345 (E.D.N.Y. 1990). In deciding whether to impose sanctions, the court is guided by the standards set forth in Eastway Construction Corp. v. New York, 762 F.2d 243, 253-54 (2d Cir. 1985):

> [A] showing of subjective bad faith is no longer required to trigger the sanctions imposed by the rule. Rather, sanctions shall be imposed against an attorney and/or his client when it apppears that a pleading has been interposed for any improper purpose, or where, after reasonable

> inquiry, a competent attorney could not form a reasonable belief that the pleading is well grounded in fact and is warranted by existing law, or a good faith argument for the extension, modification or reversal of existing law.
>
> . . . Courts must strive to avoid the wisdom of hindsight in determining whether a pleading was valid when signed, and any and all doubts must be resolved in favor of the signer. But where it is patently clear that a claim has absolutely no chance of success under the existing precedents, and where no reasonable argument can be advanced to extend, modify or reverse the law it stands, Rule 11 has been violated.

[Emphasis and citations omitted.] Under these standards, plaintiff's cross-motion for sanctions must be denied. GEX has asserted that Elul had sufficient equity in 14 Whale Square and elsewhere to obtain funding. Elul has countered that it simply did not have sufficient assets to do so. Both parties' contentions suffer from a lack of persuasive, concrete, factual support, making it impossible for the court to determine, based on the evidence in the record, whether Elul actually could have obtained the requisite bond.

The court cannot assess whether Elul's statements were true or false, and whether they were the product of reasonable investigation. Accordingly, the court cannot say that it is "patently clear" that Elul's representations violated Rule 11.

In sum, Elul's motion for an order vacating the default is denied, as are Elul's motions to amend Judge McLaughlin's Memorandum and Order, Elul's motion to consolidate a separate action for GEX's allegedly unpaid rent and a related request for attachment. Finally, GEX's cross-motion for sanctions is also denied.

SO ORDERED.

Dated: Brooklyn, New York
July 29, 1991

I. LEO GLASSER, U.S.D.J.

92-882

No. [redacted]

Supreme Court, U.S.
FILED
DEC 18 1992
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

E.L.U.L. REALTY CORP.,

Petitioner,

vs.

GREYHOUND EXHIBITGROUP, INC.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

KENNETH A. BLOOM
Counsel of Record
DOUGLAS B. LANG
ARNOLD C. JOSEPH
COZEN AND O'CONNOR
Attorneys for Respondent
Greyhound Exhibitgroup, Inc.
45 Broadway Atrium
New York, New York 10006
(212) 509-9400

QUESTIONS PRESENTED

1. Should this Court review a decision of the Court of Appeals for the Second Circuit affirming the District Court's refusal to allow evidence of the comparative fault of the parties at a damages Inquest held after petitioner had defaulted?

2. Should this Court review a decision of the Court of Appeals for the Second Circuit affirming the District Court's determination that petitioner's claim of a set off was barred as a compulsory counterclaim by Fed. R. Civ. P. 13?

3. Should this Court review a decision of the Court of Appeals affirming the District Court's refusal to modify the condition imposed pursuant to Fed. R. Civ. P. 55(c) that petitioner post a $1,000,000 bond in order to vacate the default judgment entered against petitioner?

STATEMENT PURSUANT TO RULE 29.1

Respondent Greyhound Exhibitgroup, Inc. is a wholly owned subsidiary of The Dial Corporation. Greyhound Exhibitgroup, Inc. has no subsidiary companies.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
STATEMENT PURSUANT TO RULE 29.1	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	v
STATEMENT OF THE CASE	2
SUMMARY OF ARGUMENT	4
I. E.L.U.L.'S PETITION FOR CERTIORARI IS MERITLESS AND SETS FORTH NO SPECIAL AND IMPORTANT REASONS WARRANTING REVIEW ON WRIT OF CERTIORARI	4
A. THE COURT OF APPEALS FOR THE SECOND CIRCUIT PROPERLY APPLIED THE CORRECT RULE OF LAW IN AFFIRMING THE DISTRICT COURT'S REFUSAL TO ALLOW PETITIONER, DURING THE INQUEST, TO ARGUE COMPARATIVE FAULT UNDER THE GUISE OF DAMAGE MITIGATION	5
B. THE COURT OF APPEALS FOR THE SECOND CIRCUIT PROPERLY APPLIED THE CORRECT RULE OF LAW IN AFFIRMING THE DISTRICT COURT'S REFUSAL TO ALLOW PETITIONER A SET OFF AGAINST RESPONDENT'S DAMAGE CLAIM	7

Page

C. THE COURT OF APPEALS FOR THE SECOND CIRCUIT PROPERLY APPLIED THE CORRECT RULE OF LAW IN AFFIRMING THE DISTRICT COURT'S REFUSAL TO MODIFY THE CONDITIONS FOR VACATUR OF THE DEFAULT JUDGMENT 8

II. CONCLUSION 9

TABLE OF AUTHORITIES

CASES	Page
Adriana Intern Corp. v. Thoeren, 913 F.2d 1406 (9th Cir. 1990)	5
Benny v. Pipes, 799 F.2d 489 (9th Cir. 1986), cert. denied., 484 U.S. 870 (1987)	5
Dillon v. Twin State Gas & Electric, 163 A. 111 (N.H. 1932)	7
Felhaber v. Indian Trails, 425 F.2d 715 (3d Cir. 1970)	6
Flax v. Koegel, 504 F.2d 702 (2d Cir. 1974)	5
Greyhound Exhibitgroup, Inc. v. E.L.U.L. Realty Corp., 973 F.2d.155 (2nd Cir. 1992)	1
Societe International v. Rogers, 357 U.S. 197 (1958)	8
TWA v. Hughes, 449 F.2d 51 (1971), reversed on other grounds, 409 U.S. 363 (1973)	5
Thorpe v. Thorpe, 364 F.2d 692 (D.C.C. 1966)	8
U.S. v. DiMucci, 879 F.2d 1488 (7th Cir. 1989)	5
STATUTES	
CPLR § 1411	6
Fed. R. Civ. P. 8	4, 5
Fed. R. Civ. P. 13	i, 4, 7, 8
Fed. R. Civ. P. 55(c)	i

No. 92-822

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

E.L.U.L. REALTY CORP.,

Petitioner,

vs.

GREYHOUND EXHIBITGROUP, INC.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

Respondent Greyhound Exhibitgroup, Inc. ("GEX" or "Respondent") respectfully requests that this Court deny petitioner's writ of certiorari that seeks review of the opinion of the United States Court of Appeals for the Second Circuit, *Greyhound Exhibitgroup, Inc. v. E.L.U.L. Realty Corp.*, No. 92-7545, reported at 973 F.2d 155.

STATEMENT OF THE CASE

The only facts essential to this Court's determination whether to grant or deny this petition for certiorari of the judgment and opinion of the Court of Appeals for the Second Circuit affirming the District Court are those facts stated below which were misstated by E.L.U.L.

This action arises from a fire which occurred at a large commercial building owned by E.L.U.L. known as 14 Whale Square, Brooklyn, New York (hereinafter "the premises"). Several tenants of the building, including GEX, sustained substantial property damage as a result of the fire. Consequently, on September 30, 1988 GEX commenced this diversity action in the United States District Court for the Eastern District of New York against E.L.U.L., its landlord and the sprinkler system contractor, seeking damages in excess of $1,500,000.00. In its complaint, GEX clearly averred that its damages were the direct and proximate result of the negligence, gross negligence and negligent omissions of E.L.U.L. in turning off an automatic sprinkler system which permitted a trash fire to become a conflagration.

This case was not, as E.L.U.L. would have this court believe, a case of "exacerbation". E.L.U.L. uses that word in its petition to raise, by implication, the concept that there were fire damages which were only exacerbated by E.L.U.L.'s conceded negligence. Nothing could be further from the truth. Had the sprinkler system, which had been deliberately disabled by E.L.U.L., been operative, the trash fire would have been extinguished in its "incipient stage". Hence, absent the rapid and uncontrolled spread of the fire, the only damage suffered by GEX would have been *de minimis*.

E.L.U.L. did not answer or otherwise plead to the complaint and on November 22, 1988, the Honorable Joseph M. McLaughlin, U.S.D.J. signed a Judgment of Default as to liability, which was duly entered by the Clerk. The District Court found that E.L.U.L.'s default was willful based upon, *inter alia*, the encumbering of the premises with a $4.5 million mortgage in violation of a Court Order and conditioned vacatur upon the posting of a $1 million bond.

After E.L.U.L. failed to post the required bond, an Inquest on damages was ordered. On September 27, 1991, the Inquest was commenced before United States District Judge Leo I. Glasser who subsequently referred the proceeding to United States Magistrate Judge John L. Caden. On December 2, 3, 4 and 10, 1991, the Inquest was held before Magistrate Caden to assess GEX's damages. During the Inquest, Magistrate Caden limited the inquiry, over the objection of E.L.U.L., to GEX's damages sustained in the fire. He specifically refused to allow E.L.U.L. to introduce testimony relative to the comparative fault of the parties. Additionally, no evidence was admitted as to those claims of E.L.U.L. against GEX, which were deemed waived by E.L.U.L.'s failure to plead. On February 21, 1992, Magistrate Judge Caden issued a Report and Recommendation which recommended that judgment be entered in the amount of $1,496,425.60 exclusive of interest. By Memorandum Opinion and Order dated April 22, 1992, Judge Glasser, essentially adopted the Magistrate's Report and Recommendation except for minor modifications.

E.L.U.L. appealed the District Court's ruling, attacking, *inter alia*, the court's refusal 1) to modify the bond requirement; 2) to admit evidence relative to the comparative fault of the parties; and 3) to admit evidence concerning any potential set off which E.L.U.L. may have had against GEX's damage claim. The United States Court of Appeals for the Second Circuit affirmed the District Court's judgment finding that the scope of damage mitigation at a post default Inquest is limited to evidence of "proximate cause" as it relates to the calculation of damages. The court also found that E.L.U.L.'s claim against GEX, relative to GEX's alleged failure to indemnify E.L.U.L. by supplying fire insurance, was a compulsory counterclaim and that by failing to assert it in a timely responsive pleading, E.L.U.L. was foreclosed from raising it in any subsequent proceeding, including the post default damages Inquest.

Petitioner has sought a Writ of Certiorari to review the Court of Appeals decision affirming the judgment of the District Court. Specifically, petitioner argues that it has been denied the right

to mitigate the amount of damages which it owes to plaintiff and that it has been denied the right to prove a meritorious defense.

SUMMARY OF ARGUMENT

I. E.L.U.L.'s PETITION FOR CERTIORARI IS MERITLESS AND SETS FORTH NO SPECIAL AND IMPORTANT REASONS WARRANTING REVIEW ON WRIT OF CERTIORARI.

E.L.U.L.'s Petition for Certiorari is meritless and sets forth no special and important reasons warranting review on Writ of Certiorari. The Second Circuit's decision does not conflict with any decision of this Court or with opinions of the other United States Courts of Appeal. Rather, the Second Circuit's decision presents a fact specific application of well settled principles of law. More to the point, it is beyond dispute that where proximate cause, relating to liability, is properly alleged in a complaint, it is completely and irrefutably established upon the defendant's default. Consequently, the relative fault of the parties is not a proper area of inquiry during an Inquest on damages after a default judgment has been entered. Fed. R. Civ. P. 8.

It is equally clear that any claim which E.L.U.L. may have had against GEX, for GEX's alleged breach of its lease obligation to furnish $1,000,000 in fire insurance, was so logically connected to GEX's claim against E.L.U.L. for fire damage, that it constituted a compulsory counterclaim. Thus, by failing to assert it in a timely responsive pleading, E.L.U.L. has forever waived its right, in any proceeding (including the post default damages Inquest) to do so. Fed. R. Civ. P. 13. Finally, it is also beyond argument that the Court of Appeals correctly found that the District Court did not abuse its discretion by refusing to modify the condition which it placed upon the vacatur of default judgment insofar as there was a finding that E.L.U.L.'s default was willful and that it was reasonable to require it to post a bond under the circumstances.

A. THE COURT OF APPEALS FOR THE SECOND CIRCUIT PROPERLY APPLIED THE CORRECT RULE OF LAW IN AFFIRMING THE DISTRICT COURT'S REFUSAL TO ALLOW PETITIONER, DURING THE INQUEST, TO ARGUE COMPARATIVE FAULT UNDER THE GUISE OF DAMAGE MITIGATION.

There is no conflict among the circuits concerning the consequences of a default judgment. The circuit courts agree that where properly plead proximate cause, going to liability, is completely and irrefutably established upon the defendant's default. *Flax v. Koegel*, 504 F.2d 702 (2d Cir. 1974); *Benny v. Pipes*, 799 F.2d 489 (9th Cir. 1986), cert. denied., 484 U.S. 870 (1987); *Adriana Intern Corp. v. Thoeren*, 913 F.2d 1406 (9th Cir. 1990); *U.S. v. DiMucci*, 879 F.2d 1488 (7th Cir. 1989). The Second Circuit correctly employed this standard below.

E.L.U.L. pays lip service to the above standard and suggests that Federal Rule of Civil Procedure 8(d) and the Second Circuit decision in *TWA v. Hughes*, 449 F.2d 51 (1971), reversed on other grounds, 409 U.S. 363 (1973) (hereinafter "TWA"), read together, stand for the proposition that where the beneficiary of a default seeks unliquidated damages, that beneficiary must *prove* that the defendant caused the damages before an award can be made. However, neither Rule 8(d) nor *TWA*, *supra*, support such a far reaching proposition. As correctly noted by the majority the damages contemplated by the Rule are damages subject to ministerial valuations rather than to an apportionment of fault. This distinction is readily apparent in the following passage from *TWA*, *supra*.:

> The outerbounds of recovery allowable are of course measured by the principle of proximate cause. The default judgment did not give [plaintiff] a blank check to recover from [defendant] any losses it had ever suffered from whatever source. It could only recover those damages arising from the acts and injuries pleaded and in this sense, it was [plaintiff's] burden to show

> "proximate cause." On the other hand, *there was no burden on [plaintiff] to show that any of [defendants] acts caused the well pleaded injuries, except as we have indicated that it had to for the purpose of establishing the extent of the injury caused [plaintiff] in dollars and cents.* (emphasis supplied)

As stated by the Second Circuit in the present case:

> There is a categorical distinction between the element of "proximate cause", as it pertains to the assignment of liability in the first instance, and "proximate cause" as it relates to the ministerial calculation of damages in the context of a default judgment. With regard to liability, the concept of proximate cause supplies the legal nexus between act and injury, and provides a necessary basis for avoiding compensation. Where it is properly alleged in a complaint, proximate cause, going to liability, is completely and irrefutably established upon the defendant's default.

Here, GEX in its complaint, sufficiently alleged that E.L.U.L.'s negligence was the proximate cause of the damages suffered in the fire. Those damages were deemed admitted upon E.L.U.L.'s failure to timely answer. Thus, E.L.U.L.'s contention that it should have been permitted to introduce evidence of GEX's comparative negligence, during the inquest, is without merit as the only damage issue to be decided was the identification and valuation of GEX's property damaged and/or destroyed as a proximate result of the fire.

Moreover, the other authorities relied upon by E.L.U.L. are also inopposite. First, the New York Comparative Negligence law, C.P.L.R. 1411 provides that a plaintiff's damages are diminished in proportion to its relative liability. Here, the default established that E.L.U.L. was 100% culpable for all damages. Second, *Felhaber v. Indian Trails*, 425 F.2d 715 (3d Cir. 1970) is distinguishable because the degree of fault between joint tortfeasors was at issue and thus, evidence which went to the question of relative fault between several tortfeasors was required.

Finally, *Dillon v. Twin State Gas & Electric*, 163 A. 111 (N.H. 1932) and other authorities standing for the proposition that a defendant cannot be held liable for injuries caused by others, should be rejected out of hand as irrelevant where, as here, the defendant defaulted and because this issue was not argued below.

B. THE COURT OF APPEALS FOR THE SECOND CIRCUIT PROPERLY APPLIED THE CORRECT RULE OF LAW IN AFFIRMING THE DISTRICT COURT'S REFUSAL TO ALLOW PETITIONER A SET OFF AGAINST RESPONDENT'S DAMAGE CLAIM.

The Second Circuit ruled that E.L.U.L. was foreclosed, under the compulsory counterclaim provision of Fed. R. Civ. P. 13, from raising a claim for GEX's alleged breach of a lease obligation to furnish $1,000,000 in liability insurance. E.L.U.L. argues that a Writ of Certiorari should be granted because the Second Circuit decision, directly conflicts with recent decisions from the Fifth and Tenth Circuit and most other authorities that have considered the issue. E.L.U.L.'s argument is both factually and legally incorrect.

First, E.L.U.L. once again misstates the facts relative to this issue. E.L.U.L. has never offered any evidence, and none was in the record before the Second Circuit to support the allegation that GEX failed to procure the insurance purportedly required under the lease. In absence of such evidence, E.L.U.L.'s argument is entirely premised upon supposition and speculation and should not be considered by this Court.

Second, in groping for a reviewable issue, Elul disingenuously ignores the majority, opinion holding that its claim for a set off was barred by the compulsory counterclaim provision of Fed. R. Civ. P. 13.

Third, E.L.U.L.'s argument is flawed for a more fundamental reason. In its Petition, E.L.U.L. now suggests for the first time (without any basis) that the Second Circuit affirmed the District

Court's decision to disallow the claim for set off, on the principle of collateral estoppel. A plain reading of the Second Circuit's decision shows that the Circuit Court grounded its decision upon principles attendant to Fed.R.Civ.P. 13(a).

E.L.U.L. raises the issue of collateral estoppel in a desperate attempt to present a reviewable issue. Since the issue of collateral estoppel was neither raised below nor provided a basis for the Second Circuit's decision, this Court should disregard the argument in its entirety and not grant review.

C. THE COURT OF APPEALS FOR THE SECOND CIRCUIT PROPERLY APPLIED THE CORRECT RULE OF LAW IN AFFIRMING THE DISTRICT COURT'S REFUSAL TO MODIFY THE CONDITIONS FOR VACATUR OF THE DEFAULT JUDGMENT.

E.L.U.L. contends that it was deprived of a constitutional right by the District Court's failure to modify the condition to post a $1 million bond to vacate the default. In support of its contention, E.L.U.L. relies primarily upon *Thorpe v. Thorpe*, 364 F.2d 692 (D.C.C. 1966). E.L.U.L.'s reliance upon *Thorpe* is misplaced.

In *Thorpe* the District of Columbia Circuit Court of Appeals held that imposition of a condition that is "impossible" for a party in default to perform may under certain circumstances constitute a denial of due process. In reaching this decision the *Thorpe* court relied upon the decision of the United States Supreme Court in *Societe International v. Rogers*, 357 U.S. 197, 209-210 (1958). This Court in the context of defendant's inability in good faith to produce documents due to the likely imposition of criminal sanctions by a foreign sovereign held that the defendant's due process rights may be implicated by imposition of an "impossible" condition. The *Rogers* Court noted the petitioners had made extensive efforts at compliance and that its inability to comply with the production order was "fostered neither by its own conduct nor by circumstances within its control." *Id.* at 211.

Here, the record is devoid of even a scintilla of evidence to support a claim of a deprivation of a constitutional magnitude. It is beyond cavil that E.L.U.L.'s claim of impossibility of posting the bond rings hollow. At no time did E.L.U.L. objectively demonstrate that it did not have the financial wherewithal to meet the condition imposed by the Court. The record clearly supports that E.L.U.L. had the ability to post the bond had it chosen to do so. In point of fact, Elul did not raise any objection to the condition for vacatur until after the time for their compliance had passed. Moreover, E.L.U.L.'s disingenuous conduct has been exposed throughout these proceedings, by its disregard of Court rules and orders, its concealing of assets and its misrepresentations to the courts below.

Clearly, E.L.U.L. is not a candidate deserving of the relief it presently seeks.

II. CONCLUSION

Respondent, Greyhound Exhibitgroup, Inc., respectfully requests that E.L.U.L.'s petition for a Writ of Certiorari be denied.

Respectfully submitted,

KENNETH A. BLOOM,
Counsel of Record
DOUGLAS B. LANG
ARNOLD C. JOSEPH
COZEN AND O'CONNOR
45 Broadway Atrium
17th Floor
New York, New York 10006
(212) 509-9400

Attorneys for Respondent
Greyhound Exhibitgroup, Inc.

Dated: December 17, 1992